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COVER: NISHANT CHOKSI; THIS PAGE, FROM TOP: ANDREANNA SEYMORE; JARED MOOSSY

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Corrections & Clarifications

Ⓑ In "Guess Who's Running to Obamacare's Rescue? (Politics & Policy, Nov. 22), Utah Senator Orrin G. Hatch was incorrectly identified as the ranking member of the Judiciary Committee. He is the second-ranking Republican. Ⓑ In "Boot Camp for Women Angels" (Enterprise, Nov. 22), Dimple Sahni should have been identified as a former, not current, Omidyar Network investment manager. She now runs her own advisory firm.

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Opening Remarks



Black Friday 2009: Nothing eases the guilt of consumption like buying gifts

JOHN GRESS/REUTERS

Shoppers, Start Your Engines

Does our economic prosperity depend on compulsive holiday spending? The case for Christmas self-control

By Drake Bennett

If Christmas did not exist, Toys 'R' Us would have to invent it—or some other joyful family-themed holiday to give millions of people the license to go on a weeks-long spending bender. These days Christmas shopping is not just a sport, it's a spectator sport. We tune in to the local news on Black Friday to see the mobs streaming into department stores and rampaging among the shelves, their wobbling shopping carts piled high with televisions and video game consoles and Nespresso machines. It's like a scene from a city under siege.

Who are these people? we think, shaking our heads. And how much are those Nespresso machines? And wouldn't I be enjoying this spectacle more if I were watching it on a bigger television, like the ones Best Buy is selling at such ridiculously low prices?

Seen from afar, or in the cold hard light of January, holiday shopping can seem a bit insane—all that time spent at the mall, or at our computer typing our credit-card expiration date into online shopping sites. Although the most common explanation for the name Black Friday is that it marks the moment when retailers climb from the red ink of loss into the black ink of annual profit, one of the earliest recorded usages was actually by Philadelphia police in the 1960s, to refer grimly to the day when traffic-clogging hordes of shoppers descended on the city's downtown.

Nevertheless, it's not easy to ignore the circus. There are, of course, the markdowns, and all those people on our gift lists. But social obligation and rational calculation can't really account for the holiday shopping experience. The truth is, retailers are depending on consumers to go a little crazy: According to the National Retail Federation, the holidays account for anywhere from 20 percent to 40 percent of its members' annual revenues. A strong shopping season can give the whole economy a short-run boost.

In the long run, though, retailers aren't doing themselves or the economy any favors by pushing shoppers' buttons so expertly. Families that max out their credit cards eventually must cut back, so spending today robs from spending tomorrow. Americans are figuring that out: The personal savings rate was 5.3 percent in September, up from 2 percent in 2007,

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before the recession struck and trillions of dollars in paper wealth were wiped out.

Still, every retailer is looking to increase profits by mastering the art of inducing purchases more effectively than the store next door. They are aided and abetted by a growing body of research that provides a remarkably complete portrait of the modern consumer, with all of his tics and foibles. The research can even help make sense of Black Friday and the complex interplay of greed, guilt, and psychic resignation that drives it.

Among other things, studies suggest that the glow we get from buying gifts for others makes us spend more on ourselves, and that the number of times we see a blandishing Christmas ad matters more than what it says. And in shopping, momentum matters a lot–buying one thing makes us far more likely to buy a second, and buying a second makes us far more likely to buy a fifth. "The marketers are incredibly smart. They usually come up with the deep psychological principles of what makes people do what they do before the psychologists do," says Robert H. Frank, a behavioral economist at Cornell University.

Above all, these findings elucidate the power of emotion in the shopping brain. They also underline just how much the holiday shopping rush depends on exactly the sort of psychological combustion that, by helping to inflate the housing bubble, derailed the U.S. economy in the first place.

With all the opportunities to eat and drink and spend too much, the holidays are a notoriously stiff test of human discipline–many people stagger into the new year feeling that they have overindulged in one way or another. Some have more self-control than others, of course, but according to psychologists who study the trait, the human species is not blessed with much of it. In many cases, overwhelming the willpower of the typical human being can be almost comically easy–a pleasant surprise for retailers, perhaps, if discouraging for the rest of us.

Baba Shiv, a Stanford University marketing professor, has looked at how "cognitive load"–the amount of mental energy a task requires–relates to willpower. In one study, Shiv had subjects memorize a two-digit or seven-digit number, then offered them a snack: either a piece of chocolate cake or a bowl of fruit salad. The subjects who memorized the longer number were twice as likely to give in to temptation and take the cake. Shiv argues that the effort of carrying around five extra digits in their heads was enough to exhaust any resolve people had to go for the healthier option. Similarly, Roy Baumeister, a psychologist at Florida State University, has found that subjects forced to eat radishes while looking at a plate of freshly baked cookies do poorer on subsequent self-control tasks.

Baumeister likens self-control to a muscle: You can build it up over time, but it gets tired and weakens as it's used. Seeing willpower this way helps explain, among other things, the efficacy of repetition in advertising: If we're at all tempted by what is being offered, eventually we're liable to give in. It also helps explain why, having foregone a second helping of cookies and eggnog, we find ourselves online later that evening trolling the iTunes store.

In addition, needing to buy Lego sets for two nephews means we're likely to end up with a cartful of toys of our own. Ravi Dhar of the Yale School of Management, who has documented the phenomenon, calls it "the shopping momentum effect." There's a certain amount of guilt, he argues, that most people experience when spending money, but having opened our wallets the first time, with each additional purchase the guilt ebbs.

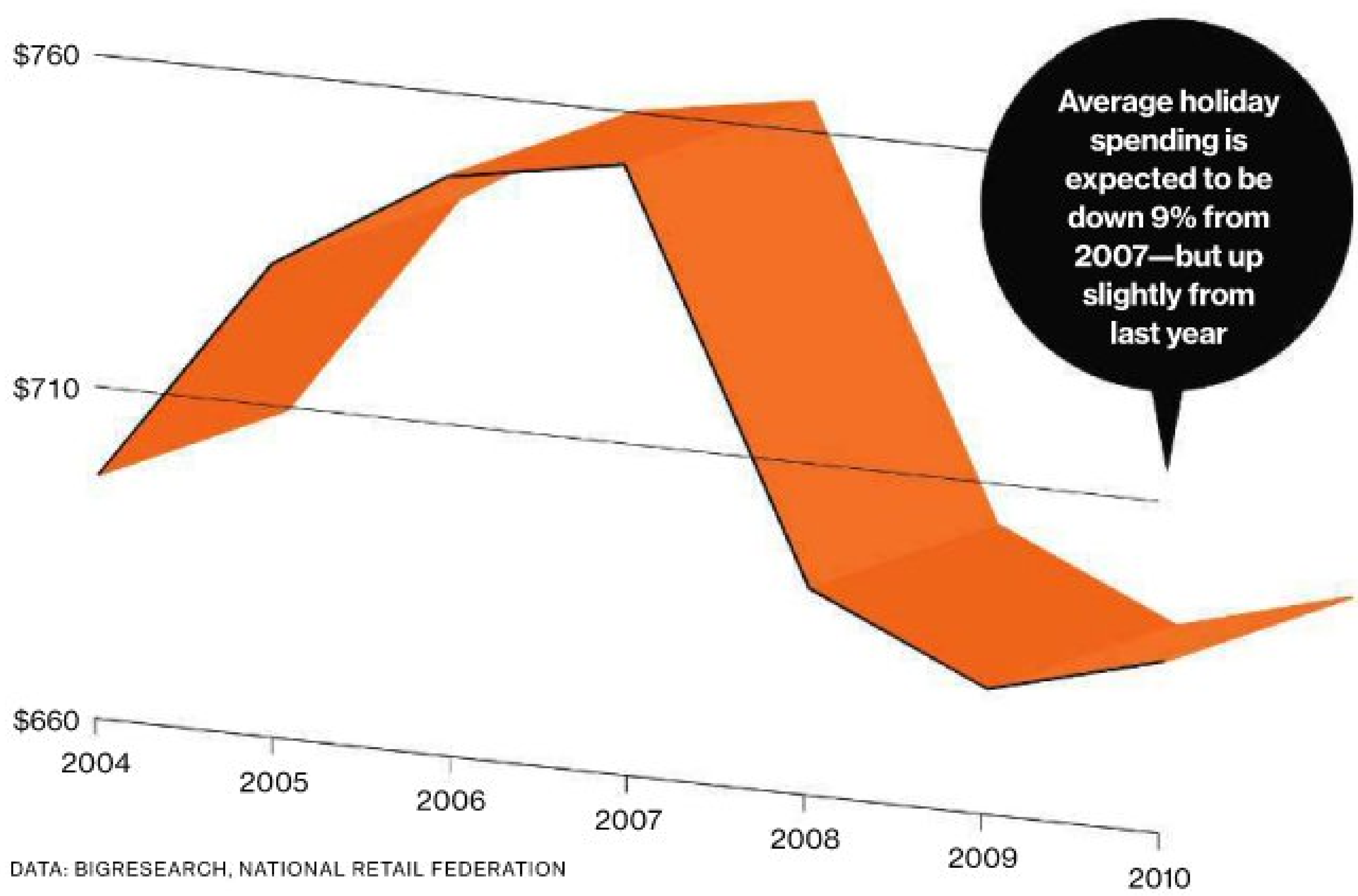
"Research has shown that just paying for something has some pain attached to it, even though you get something back in return," Dhar says. "But after you've bought the first item, the second item doesn't hurt as much."

And it turns out that nothing assuages the guilt of consumption like buying gifts. Psychologists call this the licensing effect. In essence, the idea is that doing something that feels virtuous (like buying someone else a present) makes us feel unconsciously entitled to do something self-indulgent (like buy ourselves a present, which can then make us feel that we need to do something virtuous again, like buy someone else a present). As the holidays draw closer, the process can feed on itself in a steady loop of spending.

Looming over all of these tendencies, though, is the issue of confidence. This year consumers are still skittish, and retailers are steeling themselves for a subdued holiday shopping season (chart). The crowds will still come, but they'll look less like looters and more like, well, shoppers. As disappointed as this leaves jewelers and toy shop owners, most macroeconomists are encouraged to see households saving more and borrowing less. "People are realizing they have to start saving the old-fashioned way, which is by putting more coins in the cookie jar instead of going out and buying more cookies," says David Rosenberg, chief economist at investment firm Gluskin Sheff. Or, put another way, they're learning to look at the cookies, but eat the radishes. **B**

Pall at the Mall

Holiday spending is still depressed (dollars per respondent)



DATA: BIGRESEARCH, NATIONAL RETAIL FEDERATION

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Make Your Mark



Giving Back

After starting her first successful business at 17 with a little college money and a big idea, Jennifer Reuting (above and right) decided to focus on educating like-minded entrepreneurs with her new venture, MyLLC.

At a time when many 17-year-olds are thinking about college, Jennifer Reuting was looking farther ahead, strategizing how to change the world—to make her mark.

After graduating early from high school in Las Vegas, Reuting knew she wanted to do something big, but she didn't know exactly what. Instead of heading immediately to college, she found a job with a firm that took companies public. She was fascinated by the process, but as quickly as she mastered her job, the firm was shut down.

While the other employees lamented the loss of their jobs, Reuting noted that since the office had already been paid up for six more months, she had free use of the space until then. "If the opportunities aren't around, you make your own," says Reuting, summarizing her approach to life.

Researching potential business opportunities, Reuting learned that major corporations are required to have a registered agent to receive paperwork regarding litigation or legislative issues. Such registered agents receive an annual fee to represent their corporate and small business clients, enabling quick responses to such notices. Spotting a market need, Reuting founded her own registered agent firm, which she named InCorp. For the next few years, Reuting spent nearly 24 hours a day running the business, even sleeping in the office in a sleeping bag.

Once InCorp was established within the corporate world, Reuting decided to turn her attention to a market where she could truly make a mark. Small business owners and entrepreneurs, who needed more guidance and education about structuring their ventures, were the people "I was really passionate about serving," she says.

She formed MyLLC.com to help small business owners and entrepreneurs incorporate or form their own limited liability companies (LLCs), to shield their personal assets from any business claims and to avoid double taxation. Since Reuting was intimately familiar with the pros and cons of the many types of business entities, she sought "to reach out and educate entrepreneurs... I wanted to spread my knowledge and assistance in that area" through MyLLC.

> "If the opportunities aren't around, you make your own."

Soon thereafter, because of her work with small business owners, she was asked to write *Limited Liability Companies for Dummies*, now in its second edition.

Reuting's strategy was to educate her clients, to become a critical resource to them. By educating new business owners regarding forming and running new businesses, MyLLC created satisfied customers who were better informed about how to be successful in business. "Education is a big priority to me, so I feel like I'm making my mark on the world in a small way," she says.

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Global Economics

$80 MILLION

Annual minimum savings needed by Campbell to offset inflation



Campbell's Quest For Productivity

▶ **The food company enlists its workers to help squeeze every efficiency out of its plants**

▶ **"We push ourselves to stretch beyond what we believe is possible"**

Every day, before their shifts begin, workers at the **Campbell Soup** factory in Maxton, N.C., huddle with managers to find ways to save the company money. The savings they achieve—and the savings realized at other companies' plants across the country—help explain why U.S. corporations are piling up profits without hiring enough people to put a big dent in unemployment.

U.S. companies slashed 8.5 million jobs during the recession. At the same time most have slowed capital investment plans. Instead, companies such as Campbell, **DuPont**, and **United Parcel Service** are asking employees to help them save cash by working smarter with existing technology. The efficiency gains make it less likely that recession-casualty jobs will come back. "When the productivity growth comes, then watch out, because that is when companies start not needing so much labor," says Edmund Phelps, a Columbia University economist and Nobel laureate.

Data compiled by Bloomberg shows that in the most recent quarter, 142 nonfinancial companies in the Standard & Poor's 500-stock index had raised operating margins by three percentage points or more from the final quarter of 2007, when the last expansion peaked. Among them were homebuilder **Lennar**, cable operator **Discovery Communications**, and **Teradyne**, a maker of chip testers.

Annual growth in productivity, or how much output is produced in an hour of work, averaged 3.4 percent in the five quarters since the 18-month recession ended in June 2009. Efficiency gains have helped profits of companies in the S&P rebound 23 percent since the fourth quarter of 2007. Sales have declined 9 percent over the same period.

Productivity gains make it less likely that recession-casualty jobs will come back

Yet the latest data from the Bureau of Labor Statistics show that while firing has slowed, hiring hasn't picked up. Job gains from new or expanding businesses were 6.1 million in the first quarter, the lowest quarterly rise since the recession ended. U.S. companies "live in a perpetual state of recession" because of global competition, says Thomas J. Schneider, chief executive officer of consultant Restructuring Associates. "They are much more disciplined about staying lean."

Joblessness in the county where Maxton is located was 11.1 percent in September. A fountain in

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Global Economics

Maxton's center is dry; the town hall clock tells the wrong time. Dave Biegger, Campbell vice-president for North America supply chain, says the reward for increased efficiency is a stable job and more business.

Productivity gains come when hundreds of nitpicky efforts combine to save time, money, and effort. On a new Swanson broth line at the plant, which processes 260 million pounds of ingredients a year, operators and mechanics numbered each gasket to speed repairs. They cut windows into the metal coverings of conveyor belts so they can spot the signs of wear. They color-coded valve handles to avoid confusion in settings.

Campbell says operating efficiency at Maxton has climbed to 85 percent of what its managers figure is the maximum possible, up from 75 percent three years ago. A 1 percent gain in plant efficiency in North America adds $3 million to operating profits. Head count at Maxton has risen to 858 from 812 in 2006, mainly because of the new broth line.

To offset inflation, the company must find $80 million in annual savings at all its plants. Beyond that, Biegger says the company needs to find a significant innovation every year. Campbell workers in 2009 reduced costs by $86 million in the U.S. soup, sauce, and beverage businesses, which had sales of $3.7 billion. In the latest quarter, earnings fell 8.2 percent because of declining soup sales.

Biegger's team is working with researchers to reinvent how Campbell makes soup. In the past, each soup had a unique recipe. Now Campbell uses common bases for multiple soups, such as chicken broth, and differentiates with seasonings, meat, and vegetables. Similarly, automakers use a common chassis for multiple cars and then differentiate. "We have to collaborate at the highest levels of the organization right down to the plant floor," says Biegger, who built a 20-person team to cut costs. "You explain, you teach, and you allow the work to evolve through the creativity of the team. Then we push ourselves to stretch beyond what we believe is possible."

The daily worker-manager huddles are about "getting everybody involved," says "Big John" Filmore, a 28-year plant veteran. "Instead of being told what to do, we get to tell people about our problems." He helped streamline production to better fit with the plant's cleaning schedules. Now operators such as Filmore review all line schedules.

Quarterly earnings reports from other U.S. companies cited productivity gains as a reason for strong profits. UPS trucks carry devices that track how many left turns against traffic its drivers have to make. The system helps drivers optimize routes and will save 1.4 million gallons of fuel per year when fully deployed, says spokesman Norman Black.

Former Federal Reserve Chairman Alan Greenspan says companies need to keep innovating or the current burst of cost-saving will run its course and margins will shrink. "We have been experiencing this harvesting for a year or so," he says. "You have to ask the question: Are we running out of backlog?" *—Craig Torres and Anthony Feld*

Bottom line *Companies such as Campbell are working hard to boost productivity. That means fewer new workers will be brought on.*

Quoted

"Bernanke has taken away the curtain in his effort to make the Fed more transparent, and he's made the Fed vulnerable. The Republicans are using him as a proxy for Obama and are determined to make life miserable for both the Fed and its chair."
—Arthur Levitt Jr., Goldman Sachs policy adviser and former chairman of the SEC





Emerging Markets

India Revives an Old Plan for New Growth

- ▶ Special economic zones are meant to duplicate China's success
- ▶ "You need to create more islands of excellence"

It takes more than an hour to drive the 25 miles of clogged, potholed highway linking New Delhi to the Noida Special Economic Zone. Inside the gate, it's a different India. A smooth four-lane road connects electronics, engineering, and textile plants. A generator guarantees that the electrical power never fails. The phone system is world-class. "It's the kind of place where one can think of doing business," says Vishnu Pal Singh, whose Noida-based **Optic Electronic India** sells night-vision devices for rifles and tanks to Germany and Poland.

India is counting on entrepreneurs such as Singh to revive a system it pioneered 45 years ago: using enclaves that offer lower taxes, less bureaucracy, and better roads and utilities to companies that want to boost exports. India tried using the zones in the 1960s and 1970s. The sites were poorly chosen, though, and the initial incentives offered to companies to move to them were inadequate, so just a few zones were opened. China adopted the approach in the 1980s, with spectacular results. The former fishing

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Noida: Investments in India's zones may double by fiscal 2012

village of Shenzhen became a special zone that developed into the one of the world's biggest export hubs.

Now India is pushing zones as Prime Minister Manmohan Singh tries to raise manufacturing to 22 percent of the economy from 17 percent. "Improving infrastructure in the entire country will take a long time. So if you want to promote industry, you need to create more islands of excellence, which these SEZs are," says Dharmakirti Joshi, chief economist at Crisil, the Mumbai-based Indian unit of Standard & Poor's.

Investment in the zones may double, to about 3 trillion rupees ($66.2 billion), by 2012, the Indian Commerce Ministry says. Exports from the special zones more than doubled in the 2009-10 fiscal year, to 2.2 trillion rupees, a quarter of India's total.

About 100 zones now operate in the country, and 478 more have been approved. The government-sponsored areas reduce red tape by using just a single office to handle permits certifying that environmental, export, and other requirements have been met. Companies operating in the zones get tax breaks for 15 years and don't have to pay local excise or customs duties.

Spread over 310 acres, the Noida zone's rows of white, two-story buildings bustle with workers loading and unloading trucks with steel pipes, cement, electrical equipment, and other materials destined for new factories. The zone has its own power plant, bus network, mail center, banks, and automatic teller machines. Proposed additions include a second generator and a six-lane highway to Delhi. Optic Electronic's Singh invested 100 million rupees to start his factory in the zone and plans to expand. "I can do business better in here since it is exempt from local laws," he says.

Companies that help build the zones are benefiting too. Shares in **Adani Power**, which co-developed the 16,000-acre Mundra Port & Special Economic Zone, one of India's largest by area, have risen 40 percent this year, vs. just under 13 percent for the benchmark Mumbai Stock Exchange index.

Because the government got serious about building the zones only relatively recently, India still lags far behind China. "The difference between Indian and Chinese SEZs is one of scale," says Rajesh Mohan Joshi, who teaches economics at the Indian Institute of Foreign Trade in New Delhi. One of India's most successful, the Santa Cruz Electronics Export Processing Zone, covers 100 acres. China's largest special zone by area is the southern island of Hainan, spread over 13,100 square miles. The Shenzhen zone includes many of the electronics factories of Taiwan-based **Foxconn**, which employs 430,000 Chinese there. All of India's zones together employ only half a million people.

The political difficulty of acquiring sizable tracts of land also hampers development of the zones in India, says N. R. Bhanumurthy, an economist at the National Institute of Public Finance and Policy in New Delhi: "Unless the government resolves the issue, India will struggle to match the manufacturing prowess of China." Singh's government is backing a land acquisition bill that may be debated soon in Parliament. The bill proposes to guarantee market prices for land seized for the zones and offer resettlement help to displaced residents.
—*Tushar Dhara*

The bottom line *India is trying to catch up to China by building special economic zones that promote manufacturing and exports.*

State Planning

China Takes Aim at Boeing and Airbus

▶ Honeywell, United Technologies, and GE are helping the Chinese

▶ "I feel proud that China can come up with such a plane"

At a recent air show in Zhuhai, China, two women in red flight attendant uniforms welcomed visitors to a mock-up of a new narrowbody jet that will seat up to 150 people and have its maiden flight in 2014. The plane is the C919, designed by state-owned Commercial Aircraft Corp. of China (Comac) to grab a piece of the passenger jet market from **Airbus** and **Boeing**. "The interior is clean and bright, not a bad feel," says Jennifer Huo, a 34-year-old public-relations executive from Shanghai. "I feel proud that China can come up with such a plane."

One reason that China can come up with such a plane is that the companies that supply Boeing and Airbus are working with Comac as well. **CFM Interna-**



The C919 will take on Airbus and Boeing; the ARJ-21 (above) is a regional jet

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Rapping hamsters help Kia's sales page 23 ▶



tional, a venture of General Electric and France's Snecma, is supplying all of the C919's engines. **GE Capital Aviation Services** (Gecas), the world's largest airplane leasing company, says it will buy as many as 10 of the new planes. "The decision to add C919s to the Gecas fleet shows our confidence in the commercial prospects for the aircraft and strengthens the relationship with our Chinese partners," Mark Norbom, president & chief executive officer of GE China, said in a statement.

Other suppliers include **United Technologies** and Honeywell. China's aviation industry today is at a similar stage as Airbus in its early days, says Tim Mahoney, president and CEO of **Honeywell Aerospace**. That's when it was a state venture with seemingly little prospect of taking on Boeing. Honeywell's four joint ventures with Chinese partners will supply parts to China's aircraft projects. One partnership focuses on flight controls, another on wheels and brakes. Honeywell also plans to expand its design center in Shanghai. "We are not just here to build an aircraft," says Bob Smith, chief technology officer of Honeywell Aerospace. "We are here to build an industry."

One goal is for the C919 to compete with the Airbus A320 and the Boeing 737. Another is "to spur the whole aviation industry," says Zhang Xinguo, vice-president at Aviation Industry Corp. of China (AVIC), a state-owned company that is helping build the airplane. The government wants to see jumbo jets, regional planes, business jets, propeller planes, and helicopters all made in China by Chinese companies.

The aerospace suppliers are positioning themselves for the day when the Boeing-Airbus duopoly will end and China horns its way in. China accounts for 22 percent of Airbus' 2010 orders and 15 percent of Boeing's orders. In the next four years, Chinese airlines are likely to double their fleet size, to 5,000 planes. On Nov. 1, Boeing said Chinese buyers will purchase $480 billion worth of aircraft over the next two decades. "There's voracious demand," says Peter Harbison, executive chairman of the Centre for Asia-Pacific Aviation, a market research firm in Sydney.

Comac has received orders from three Chinese airlines and two leasing companies, all of them state-owned, for 90 of its C919s. Even if interest in China's aircraft industry is limited largely to the home market, the growth of the country's carriers should guarantee plenty of business for Comac, AVIC, and their Western suppliers.

The icing on the cake for Chinese aircraft makers and their foreign partners would come if the Chinese start selling their planes outside of China. "The Chinese manufacturers will reduce the market share of Boeing and Airbus," says Harbison of the Centre for Asia-Pacific Aviation. "But this is not going to make a dramatic impact overnight."

China's industrial planners are willing to be patient. **Huawei Technologies**, **Cisco System**'s big Chinese rival, needed years before it became a global player. China's high-speed train industry has been going through the same changeover from local champion to international force. Its aerospace industry may be starting the same transition. Honeywell's Mahoney is already talking about developing products "that would service not only the Chinese market but also the markets that the Chinese would provide globally. Similar to what we do with Airbus and Boeing." *—Bruce Einhorn, with Liza Lin and John Liu*

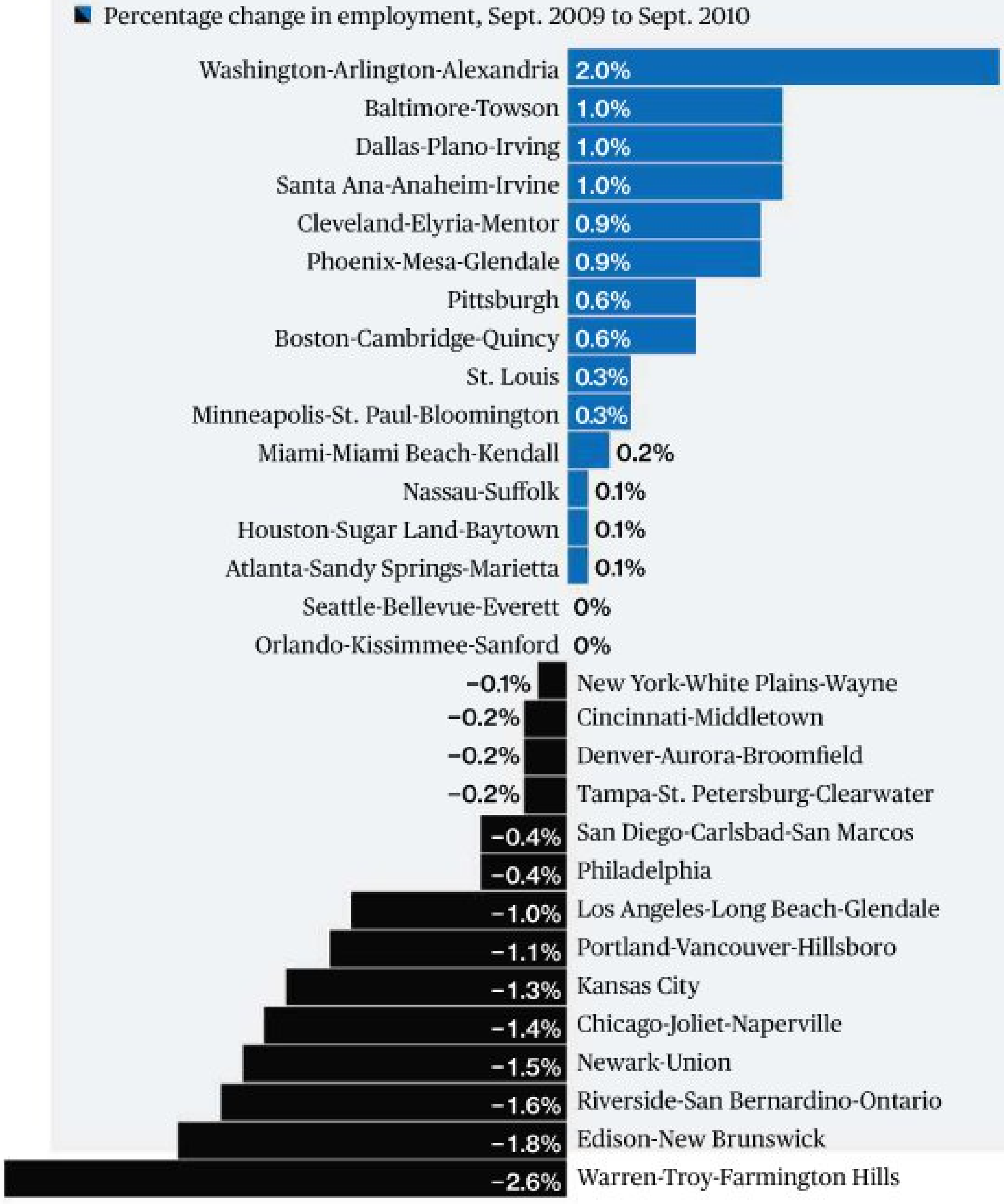
The bottom line *China's commercial aircraft industry is getting help from Western aerospace companies that are branching out beyond Boeing and Airbus.*

Employment

Which Cities Have Jobs—and Which Don't

Job growth varies greatly in America's cities, as this table of the 30 biggest gainers and losers shows. Suburban Detroit lost more jobs than any other major metro area, while the Washington area fared best. *—Phil Kuntz and Peter Coy*

■ Percentage change in employment, Sept. 2009 to Sept. 2010



DATA: BUREAU OF LABOR STATISTICS

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Gobble! ▶

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Bailouts

Battered Ireland Clings To Its Low Taxes



▶ Though it needs $115 billion, its low corporate rate is "non-negotiable"

▶ "If the tax rate increased, we would be relooking at our investment"

Even before Irish Prime Minister Brian Cowen (above) announced he was seeking the help of the European Union and the International Monetary Fund–and dissolving the government–the Irish were intent on passing an austerity budget by yearend. The EU and the IMF, which may extend to Ireland emergency loans as much €85 billion ($115 billion), couldn't ask for a more compliant patient–except in one area.

The Irish credit much of their precrisis economic success to a policy of charging corporations only 12.5 percent in income tax, one of the lowest corporate rates in Europe. That rate, which compares with 28 percent or higher in Britain, France, Germany, and the U.S., has lured multinationals to set up manufacturing, research, and service centers in Ireland over the last 20 years.

Now various officials in Europe are calling on the Irish to raise funds by hiking taxes. Olli Rehn, the EU's economic and monetary affairs commissioner, has stated that Ireland cannot be a low-tax economy any more. French President Nicolas Sarkozy has said that while it's not his business, he could not see how the Irish could avoid hiking the corporate rate. Various members of Germany Chancellor Angela Merkel's ruling party have said Ireland should consider raising the corporate rate.

The Irish are pushing back. Deputy Prime Minister Mary Coughlan told Parliament on Nov. 18 that the 12.5 percent rate was "non-negotiable." Supporting the Irish are the multinationals. The American Chamber of Commerce in Ireland backed by **Bank of America Merrill Lynch**, **Hewlett-Packard**, **Intel**, and **Microsoft** warned the IMF, the European Central Bank, and the European Commission of the "damaging impact" on Ireland's "ability to win and retain investment" in the event that corporate taxes go up. "HP is very clear," Lionel Alexander, head of Hewlett-Packard's Irish operations, told Bloomberg Television. "If the tax rate increased, we would be relooking at our investment in Ireland."

Hewlett-Packard employs more than 4,000 people in Ireland, and multinationals' operations account for about 70 percent of the country's exports. "It would be counterproductive to raise taxes in the current environment," says Sylvain Broyer, chief euro-region economist at a bank group, Natixis, in Frankfurt. "They might have to adjust tax rates at some point but not during an emergency situation. It would be a grave mistake."

Adding to the tension is the long history of criticism directed at Ireland by other EU member states for adopting a low-tax strategy in high-tax Europe. While France and Germany have stuck with high rates, new EU members–including Bulgaria, Cyprus, Latvia, and Lithuania–have adopted the Irish model. How Ireland adjusts its taxes has implications far beyond its bailout.
—*Colm Heatley and Elliott Gotkine*

The bottom line *Ireland is balking at hiking corporate taxes as a condition of an EU-IMF bailout. It credits its past economic success to low taxes.*

The House of Windsor

Britain Looks for a Royal Wedding Dividend

▶ Will and Kate mugs, T-shirts, iPhone covers. IPhone covers?

▶ "The monarchy is a major reason why tourists come to this country"

A day after the announcement of Britain's next royal wedding, Paul Hirst sped up production at his factory in Sheffield. The managing director of **Marvelpress** had gotten an order for "thousands and thousands" of commemorative engagement mugs from **Wal-Mart Stores**'

Tom Keene's EconoChat

Tom talks with the University of Maryland's **Carmen M. Reinhart** on debt crises and how they play out.

Professor Reinhart is co-author of *This Time Is Different*, a history of defaults that is without question the economics book of the last 18 months. Professor, all of what we're seeing has happened before, hasn't it?
Yes, indeed. The Irish situation is quite reminiscent of the early 1980s, when bank debts started the roller coaster, rather than sovereign debt, as was the case in Greece.

Is bailing out the Irish banks the same thing as bailing out the Irish government?
Not yet, because those banks are still in private hands. The Irish government better be careful how it takes on the bank debts. Since this crisis, it's been taking on a massive amount of debt in what I have argued were completely overpriced conditions.

The Greek problem is back, too.
We can wish away high levels of debt, but that's just what it is–it's wishing them away. The debt problems that we have in Ireland, that we have in Greece, that we have in the U.S., that we have in Japan–they have different compositions and different degrees of severity. But they going to be with us for a while.

I'm not sure if anybody knows just who owes what to whom.
One of the reasons that we got into the "too big to fail" problem in the U.S., as elsewhere, is that we don't know who owes what to whom. So isolating the patient becomes very difficult.



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

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Global Economics



Nuptial memorabilia could help add $995 million to the economy

Britain-based supermarket chain, **Asda**. "It was all hands to the pumps to get everything done in time," says Hirst. "We're looking at making iPhone covers, Champagne and wine boxes."

Prince William's engagement to Catherine Middleton has kicked off the race to profit from what will be the biggest royal event in Britain since Prince Charles wed Lady Diana Spencer in 1981. According to Verdict Research, a retail analysis unit of Datamonitor, the affair, set for Apr. 29, may add £620 million ($995 million) to the economy as consumers spend more on Champagne and other celebratory treats, extra planeloads of tourists fly in, and the likes of Hirst sell separate sets of memorabilia for the engagement period and the nuptials themselves.

It helps if royal mania is affordable. For £16, British retailer **Tesco** will sell a replica of the designer dress Middleton wore at the engagement announcement on Nov. 16. On the **QVC** shopping channel on Nov. 17, telephone sales of a ring resembling the one William gave to Middleton jumped ninefold overnight, Marketing Director Sue Leeson said in an e-mail. (The QVC price: £34.) "It will be interesting to see what impact [Middleton] has on British style." said Leeson.

The U.K. economy could do with the boost. The Bank of England predicts growth of 1.8 percent this year and 2.6 percent next, following a slump of 5 percent last year. After the coronation in 1953, the silver jubilee celebration in 1977, and the royal wedding in 1981, the economy picked up its pace, according to an analysis of the data by Bloomberg.

The royal family already prompts tourists to spend more than £500 million a year, says the state-funded tourism board, VisitBritain. "The monarchy is a major reason why overseas tourists come to this country," says VisitBritain spokesman Paul Eastham. "In a royal wedding year, that figure is going to be massively exceeded." Ⓑ —*Chris Spillane*

The bottom line *The engagement and wedding of Prince William and Catherine Middleton will boost the British economy as tourists and locals celebrate.*

Seven Days

Events of note in the week ahead

by Ira Boudway

29

Japan's unemployment rate for October

Spanish Soccer: Barcelona FC hosts Real Madrid

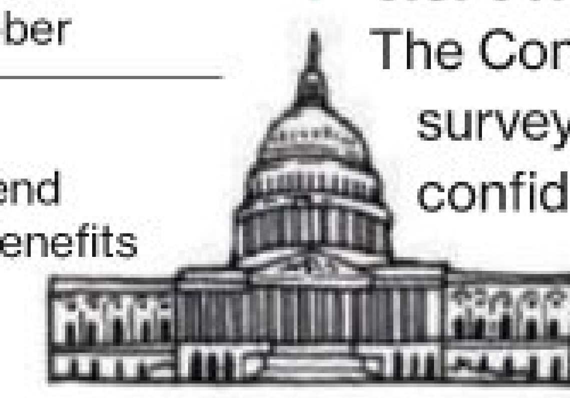


▶ **European Commission economic growth forecast:** The EC has envisaged a faster-than-expected recovery for Europe. Ireland's bank crisis clouds the issue.

30

Brazil's budget balance for October

Deadline for U.S. Congress to extend unemployment benefits



▶ **U.S. Consumer Confidence:** The Conference Board's monthly survey showed slightly improved confidence in October, though it still hovers near record lows.

01

The Federal Reserve's Beige Book

India's trade balance for October



▶ **U.S. deficit:** The National Commission on Fiscal Responsibility and Reform meets to make its final recommendations .

02

Art Basel Miami Beach begins

NBA: LeBron James returns to Cleveland for the first time with the Miami Heat



▶ **Kroger earnings:** The grocery-store chain beat analysts' profit estimates in the past two quarters by using promotions to fend off competition from Wal-Mart.



03

Germany's retail sales for October

Canada's unemployment rate for November

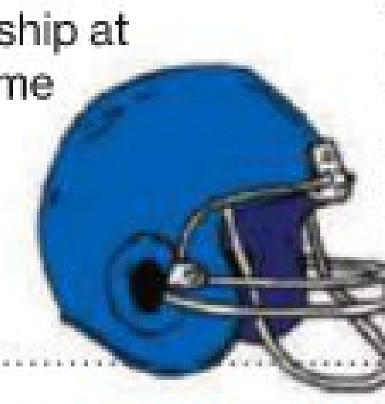


▶ **U.S. unemployment:** Surveyed economists expect the November rate to hold at 9.6 percent.



04

College football: Auburn vs. South Carolina in the SEC Championship at the Georgia Dome



▶ **International Finance Exposition:** Southern China's industrial hub, Shenzhen, opens its fourth annual gathering of more than 500 financial companies.

05

Las Vegas marathon



▶ **Iran nuclear talks:** European Union foreign policy chief Catherine Ashton and Iran's nuclear negotiator Saeed Jalili are scheduled to meet in Geneva.

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Companies&Industries



🔈 **This** or **that**...



You can get with **this**...



Or you can get with **that**...



You can get with **this**...



Or you can get with **that**...



You can get with **this**...



Or you can get with **that**...



I think you'll get with **this**...



'Cause **this** is kinda phat.

How Kia Is Rapping Its Way Into America's Heart

▶ The Korean automaker is luring more drivers with low prices and edgy ads

▶ "The image of Kia's old models with poor quality hasn't completely disappeared"

How does a company like **Kia Motors**, with a reputation for so-so quality, thrive when the U.S. unemployment rate is 9.6 percent and many household budgets are ultra-tight? First, the No. 2 Korean automaker has kept average prices of its cars about $8,000 below those of key market rivals. Next, cue the rapping hamsters. Kia is blanketing American television with commercials starring human-size hamsters that rap to the hip-hop group Black Sheep's song *The Choice is Yours* while driving Kia's boxy Soul wagon through an urban landscape.

It's all loud and a bit crazed, but the strategy seems to be working. Kia's U.S. sales gained 15 percent this year through October, outpacing growth at **General Motors**, **Toyota Motor**, and **Honda Motor**. If Kia can keep it up, it should log its highest annual U.S. sales ever. "People are looking for value in this market, and they're looking at brands they might not have considered in the past," says Rebecca Lindland, director of U.S. auto industry research with IHS Automotive. "The advertisements are so good and are helping to create a buzz for the models."

To be sure, pricing is a decisive factor behind Kia's appeal. Its passenger vehicles sell for an average of $21,598, compared with the industry average of $29,494, says Edmunds.com, an auto-industry data provider. Still, the company's advertising has helped improve Kia's brand awareness in the U.S. among young car buyers and families with kids. Thanks to its popularity on **Google**'s YouTube and social media sites, the spot logged more than a million views online in the first two months, according to the company.

While that marketing buzz is welcome, Kia's slide in U.S. quality rankings remains a problem. Kia dropped 10 places, to 25th, in J.D. Power and Associates' latest survey of initial quality of mass-market and luxury brands, and *Consumer Reports* recommended only three of the Korean automaker's eight models. Customers complained about wind noise and the interior design in Kia's Forte compact, says Raffi Festekjian, director of automotive product research at J.D. Power. A separate J.D. Power survey on vehicle dependability, assessing the quality of models on the road for three years, rated Kia 20th. The company also recalled

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about 104,000 vehicles worldwide this year because of an electrical wiring problem that can cause fires. The recall prompted former production chief Jeong Sung Eun to resign as vice-chairman in September, according to Kia spokesman Michael Choo.

Kia's woes are in stark contrast with the image for quality enjoyed by **Hyundai Motor**, Korea's largest automaker and owner of a controlling 34 percent stake in Kia. The differing perceptions of Kia and Hyundai vehicles (which generally score well in J.D. Powers surveys) is surprising, since the two companies share some vehicle platforms, engines, parts suppliers, and a chairman. The companies retain separate factories and workforces, however. Kia improved its design after the recruitment of former top **Audi** designer Peter Schreyer. "The image of Kia's old models with poor quality hasn't completely disappeared," says Charles Bang, director of the division overseeing quality at Hyundai and Kia in Seoul. "But it's not correct to say there's a huge quality gap between Hyundai's and Kia's cars."

This year the automakers opened a second joint quality-management center near Seoul. They plan to produce 40 models with six shared platforms by 2013, vs. 32 models with 18 platforms last year. Back in 1999, a year after Hyundai bought control of Kia, the two companies shared only 18 percent of their combined 740 parts suppliers. By 2009, they shared 78 percent of 400. "The new cars they're bringing out are much more competitive, but it takes time to change that perception," says Jeremy Anwyl, chief executive officer of Edmunds.com.

Kia's U.S. lineup is led by the Sorento and Sportage SUVs, the Soul, and the Forte and Optima cars. All were either introduced or revamped in the last two years, offering buyers a reason to give Kia a try. Michael Mincey of Orlando this year bought his first Kia, a Soul, after being turned onto the brand by a buddy and discovering the car had better fuel economy than his **Chrysler** Jeep and a comparable interior. "A friend mentioned the Soul because he liked the commercials," Mincey said. "I took a look, went for a test drive, did my research, and I was sold."

—*Alan Ohnsman and Sookyung Seo*

The bottom line *Despite low quality scores, Korean automaker Kia is on a roll in the U.S. Its image is benefiting from TV ads featuring rapping hamsters.*

Quoted

"We are now primarily a streaming-video company"
—Netflix CEO Reed Hastings in a Nov. 22 statement, explaining a new $7.99-a-month, streaming-only video subscription, the company's first plan that doesn't include DVD mailings



Pharmaceuticals

Is Merck's Cholesterol Pill the Next Lipitor?

- ▶ A new cholesterol treatment promises to do what no other does
- ▶ "This is totally unprecedented territory," says a cardiologist

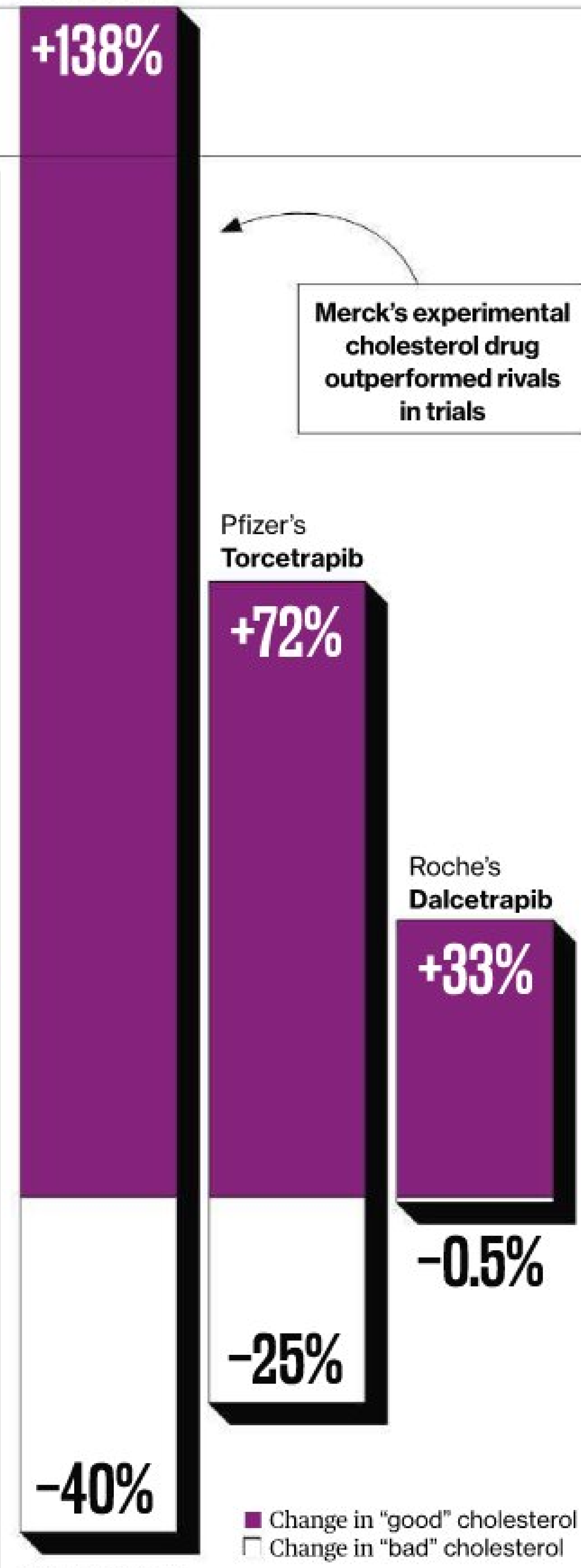
In 2006, **Pfizer**, the world's biggest drugmaker, shelved a cholesterol pill it spent $1 billion to develop after a study found the drug, called torcetrapib, raised blood pressure and actually caused more heart attacks. Pfizer's decision left rival **Merck** with a tough call. Merck had also spent years pursuing a new drug that would boost the good cholesterol that ferries fat out of the bloodstream while at the same time reducing bad cholesterol.

Its own treatment, anacetrapib, was still unproven; the company risked throwing good money after bad. "There was a huge debate at every level from the research teams to the top levels of leadership," recalls Luciano Rossetti, Merck's senior vice-president for global scientific strategy.

For six months, Merck's researchers tested and retested anacetrapib. The results came up positive; the drug didn't raise blood pressure in animals. Chief Executive Officer Richard T. Clark decided that Merck would press ahead.

That gamble paid off: On Nov. 17, Merck told thousands of heart doctors gathered in Chicago for the American Heart Assn. annual meeting that new data showed that anacetrapib reduced bad cholesterol by 40 percent while raising good cholesterol by an unprecedented 138 percent in a study of 1,623 patients. "If what we are seeing now is borne out in larger studies, this could be the next big thing that could benefit hundreds of millions of people," said Christopher P. Cannon, the study's lead researcher and a cardiologist at Brigham and Women's Hospital in Boston. "This is totally unprecedented territory."

Pfizer and Merck have been locked in a 25-year battle to dominate the market for cholesterol drugs, which last year topped $35 billion worldwide, according to researcher IMS Health. The standard treatments for high cholesterol, called



DATA: COMPANIES

CLOCKWISE FROM LEFT: RYAN ANSON/BLOOMBERG; JOSHUA ROBERTS/BLOOMBERG; WARNER BROS/EVERETT COLLECTION; WARNER BROS; MARY EVANS/NEW LINE CINEMA/EVERETT COLLECTION; WARNER BROS

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America's pat-down czar page 35 ▶



statins, work by reducing levels of LDL, the bad cholesterol that clogs arteries and causes heart attacks. In 1987, Merck received approval to market the first statin, called Mevacor. Pfizer followed a decade later with Lipitor, a drug in the same family that soon became the world's best-selling medicine, with $11.4 billion in sales last year.

Lipitor has been hard to beat, so pharmaceutical companies in search of new blockbuster drugs have been shifting their focus to areas where breakthroughs may be easier to come by. Even Pfizer: In January the company said it would narrow its drug-development pipeline to 500 projects in six disease areas; cardiovascular wasn't one of them.

That tips the balance in favor of Merck, which boasts a promising pipeline of cardiovascular drugs in late-stage trials involving some 120,000 patients. Anacetrapib is one of four treatments in final testing to prevent heart clogs and blood clots that each have the potential for at least $1 billion in yearly sales by 2016, according to Robert Hazlett, an analyst at BMO Capital Markets. Two of the drugs target cholesterol, and the other two aim to prevent clots. Merck researchers are particularly bullish on vorapaxar, which they believe may achieve the ultimate goal of a blood thinner: to lower the risk of blood clots without causing excessive bleeding. The company plans to seek regulatory approval next year, pending results of a 40,000-patient study. That means the drug could hit the market around the time **Bristol-Myers Squibb**'s Plavix, the leading blood thinner with $10 billion in worldwide sales, is set to go off patent in the U.S.

Vorapaxar and anacetrapib each have the potential to exceed $5 billion a year in sales if they aren't sidelined by side effects, figures BMO's Hazlett. Anacetrapib may even accomplish what no other drug in history has been able to do: outsell Lipitor. A rival experimental drug from Switzerland's **Roche** has not performed as well in studies. Says Hazlett: "Other organizations have notably pulled back, and to their credit, Merck has continued to focus, making good, well-calculated bets."
—*Tom Randall*

The bottom line *In the 25-year battle for dominance of the $35 billion cholesterol market, the balance of power is now tipping to Merck.*

Entertainment

Warner Seeks A New Harry Potter

▶ With the sorcerer's saga ending, Warner taps its comic book stable

▶ "I don't think there's one obvious successor"

Warner Bros., whose *Harry Potter and the Deathly Hallows–Part 1* hauled in $125 million in the U.S. and Canada on its first weekend to record the sixth-biggest box office debut in movie history, faces a task even a wizard would find daunting: replacing a series that is expected to hit $7.5 billion in ticket sales by the time it ends next summer. J.K. Rowling's tale of the young sorcerer, concluding with an eighth film in July, is the highest-grossing film franchise ever.

Time Warner's film studio will turn to DC Comics superheroes such as Batman, *Sherlock Holmes* sequels, and two prequels to the *The Lord of the Rings* trilogy. "We have been developing [other] properties that are starting to look like franchises," says Alan Horn, Warner's president and chief operating officer. "Is *Sherlock* [which sold $523 million in tickets worldwide last year] a franchise? I would argue yes. Is *The Hangover* series [the first film took in $467 million] a franchise? You could argue it is."

The Potter films, along with lucrative series such as *The Lord of the Rings* and *The Matrix*, have made Warner the top-grossing studio in seven of the past 10 years. The impact of a single installment can be outsized: In 2009, *Harry Potter and the Half-Blood Prince* accounted for 14 percent of Warner's $2.11 billion in domestic ticket sales, according to Box Office Mojo, an industry website.

Replacing Harry and his pals at Hogwarts School of Witchcraft and Wizardry won't be easy. "I don't think there's one obvious successor," says David Bank, an analyst with RBC Capital Markets. "If I were looking for it somewhere, it's the DC catalog."

Time Warner, which has owned DC Comics since 1969, made the unit part of its film division last year in a move that highlighted the importance of the characters for future films. "We're doing our best to get the DC properties lined up like airplanes taking off from the runway," Horn says. Several projects based on DC Comics superheroes are under way. In June 2011, Warner will release its *Green Lantern* movie, which stars Ryan Reynolds as a test pilot with superpowers. The studio is also developing a *Superman* film, more *Batman* installments, and movies based on vintage action heroes Wonder Woman, the Flash, Green Arrow, and Aquaman, Horn says. Not every DC entry has been a hit. *Jonah Hex*, starring Josh Brolin as a bounty hunter in the Old West, took in just $10.9 million worldwide last summer. It cost $47 million to make, says Box Office Mojo.

The Potter movies, which have already raked in $1 billion more than **Twentieth Century Fox**'s six *Star Wars* films, have provided the studio with stability in an unpredictable industry, says Bank. The strongest

In Search of the Next Matinee Idol

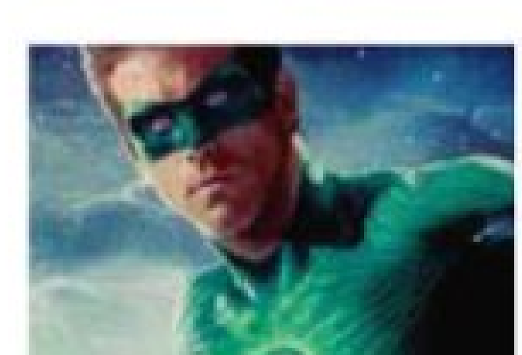
With the Harry Potter saga set to end in 2011, here's where Warner Bros. will turn next





The Hobbit prequels

Director Peter Jackson plans two *Lord of the Rings* prequels chronicling the early adventures of hobbit Bilbo Baggins and the wizard Gandalf.



DC Comics stable

Warner is dusting off venerable DC characters including Green Lantern, Wonder Woman, and the Flash in its search for new box-office winners.



Franchise wannabes

Sherlock Holmes and the comedy *The Hangover* are getting sequel treatment after their first installments drew hundreds of millions in ticket sales.

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opening of any Potter film was *Deathly Hallows–Part 1*. It may take in as much as $900 million, says Porter Bibb, a managing partner of Mediatech Capital Partners. The film cost about $250 million to make, according to Internet Movie Database. The series so far has produced a profit of about $1 billion if income from home-video, games, and other products is also tallied, according to Warner.

$7.5 BILLION

Expected total sales for the Potter movies by late 2011

The studio's performance is increasingly important to parent Time Warner. Since the media giant completed the spin-off of its cable TV operations in March 2009, the studio's share of total revenue has doubled, to almost 42 percent. Filmed entertainment contributed 14 percent of profit last quarter.

Including *Deathly Hallows–Part 2*, which opens on July 15 in 3D, the Potter series is expected to produce $7.5 billion in theaters, Warner Chief Executive Officer Barry M. Meyer said in September. Warner and partner **Metro-Goldwyn-Mayer** will try to duplicate that success with two films based on *The Hobbit*, the J.R.R. Tolkien book featuring characters who appeared in the *Rings* series. The studios aren't taking any chances: They've signed Peter Jackson, director of *The Lord of the Rings* films, to also helm the *The Hobbit* movies. —*Michael White*

The bottom line *Warner Bros.' Harry Potter films have been the industry's biggest. With the saga ending in 2011, the studio needs a new growth engine.*

Autos

For Luxury Automakers, Selling Toys Is No Game

▶ German car companies woo kids as a way to burnish their brands

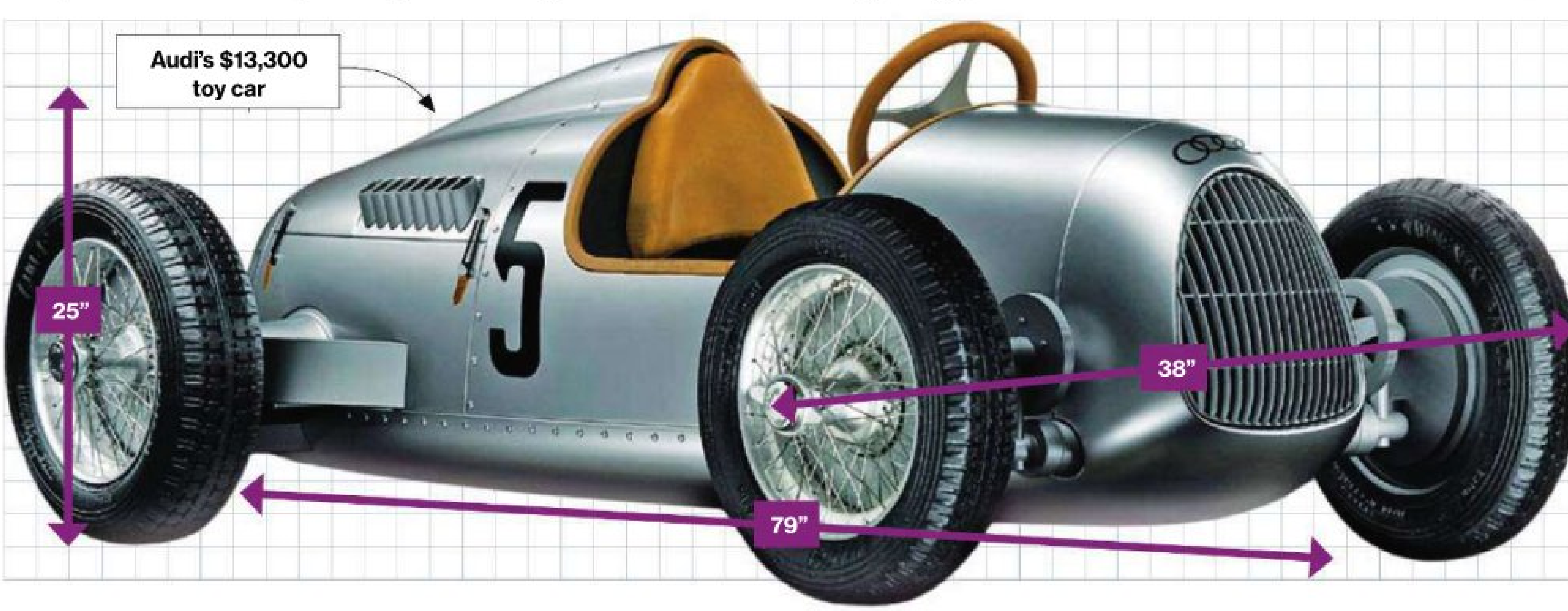
▶ "We are a marketing effort that makes money"

In recent years, Germany's Big Three automakers have been locked in a tight race for dominance of the luxury car market. Now the rivalry between **BMW**, **Mercedes-Benz**, and **Volkswagen**'s Audi has expanded to include a holiday season battle for playground prestige with new push cars and snow sleds that target the next generation of drivers. Audi set the standard for luxury kid toys with a limited edition pedal-powered version of the Auto Union Type C, which it showed at the Nuremberg toy fair in February. The scale model of the 1930s racer, designed for kids up to 135 centimeters (4 ft. 5 in.) tall, has an aluminum frame, hydraulic brakes, seven speeds, leather-clad steering wheel, and oak dashboard. The car retails for €9,700 ($13,300), making it Audi's most expensive kid toy; only 100 of the 500-unit run remain unsold.

BMW is firing back in time for Christmas with new BMW- and Mini-branded sleds for €79 apiece. **Daimler**'s Mercedes is countering with a version of the gull-wing SLS supercar for toddlers, due in April for €90 each. The carmakers are quick to explain that there's more to gain by promoting kid-focused merchandise than simply making a few euros. "Merchandising is important not because you can make huge money with it, but because it's another means of positioning your brand," says Peter Schwarzenbauer, Audi's sales chief. "We're thinking about more products that are not directly related to our cars but set design standards in other areas," such as a €12,900 tabletop soccer game.

Audi also has a line of teddy bears, including one decked out in a motorracing suit for €47, and a modern pedal-powered alternative to the exclusive Type C. The red plastic racer for €299 features an adjustable rollover bar, hand brake, over-sized tires with Audi-style rims, and padded seats.

Luxury carmakers go to great lengths to add details that ensure their toys stand out. BMW's Snow Racer sled has replaceable metal runners, a suspension-system in the red steering ski, and a horn to warn inattentive passersby. In April, Mercedes will roll out the foot-powered SLS Bobby-Benz, featuring headlights, grill, and rear end similar to those of the company's $183,000 SLS sportscar. The toy SLS features quiet-running tires, an Ackermann steering system with tight cornering for living-room maneuverability, and a steering wheel that absorbs impact to prevent injury in the event of a collision. "All the products have to live up to Mercedes' standards for quality and safety—especially our toys, which are all-time favorites with the next generation of Mercedes-Benz customers," says Christian Boucke, head of Mercedes-Benz Accessories. The



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10-year-old unit offers 15,000 products, including $24 silver Christmas ornaments, a $139 tote bag made from seatbelts, and a retractable pet leash for $15.50.

BMW began its lifestyle business 15 years ago. Today it sells more than 2,000 products including €39 Mini rain boots and the €1,500 bike from BMW's M performance unit. The company also introduced a kid edition of the M3 GT2 race car. The battery-powered version, which costs €349, has forward and reverse gears, and a top speed of 2.5 miles per hour. "We are first and foremost a marketing initiative, and the main objectives are to broaden the brand's presence and strengthen loyalty," says Thomas Goerdt, head of the merchandising and lifestyle unit. "We are a marketing effort that makes money." He says the unit enjoys profit margins similar to those generated from selling real cars. (BMW is targeting a margin of more than 7 percent this year on its auto business.)

While luxury consumers want a wide range of products to communicate their association with a favored brand, "merchandising needs to be kept in check so that it doesn't overstretch the brand or interfere with the core business of selling cars," says Michel Gabriel, managing director for consultancy Interbrand in Zurich, who has previously advised Audi on branding issues. "Sometimes you have to say no, even if a lot of money can be made from a product" such as branded underwear, he says.



BMW's €79 Snow Racer has a suspension system in the red ski

Christoph Stuermer, an analyst with IHS Automotive in Frankfurt, agrees carmakers have to be cautious not to dilute their brands. "Merchandising is always a little risky," Stuermer says. "It's a fairly delicate balance, because when you start putting an auto brand on a watch or a pair of sunglasses, the brand's authenticity can be called into question."

Still, toys are a particular attraction for car companies because they tighten relations with current customers and provide an opportunity to develop in future drivers an affinity for the brand. Take the kids of Sonny Kim. While having winter tires put on her 2007 A-Class hatchback at the Mercedes Center in Berlin, the 36-year-old graphic designer spotted a pedal car that sells for between €179 and €205. She thought it would make an ideal gift for her two- and four-year-old boys. "It would be nice for the kids to drive the same thing as mom and dad," she says. "It would be a nice bond."

When it comes to exclusive kid toys, Europe's top-three premium car brands are chasing **Aston Martin**. The ultra-luxury British automaker sold mini motorized replicas of the V8 Vantage Volante and Virage in the late 1980s and early '90s to customers including Prince Charles. The Aston Martin Volante Junior, which retailed at £15,000 ($24,000) plus tax, has a gasoline engine and a top speed of more than 30 miles per hour. The cars have resold for as high as £25,000, according to Roger Bennington, managing director of Stratton Motor, one of the world's largest Aston Martin dealers. "A lot of people bought them as a collector's item when they had a new car built and would normally have the Junior built to the same specification," says Bennington. "I don't actually think many kids got to use them as they were normally the prized possession of the Aston Martin owner. They were also a little bit too fast for children."

—*Chris Reiter*

***The bottom line** Europe's luxury carmakers hope to bolster their brands by selling expensive toy cars aimed at children—tomorrow's buyers.*



Confections

Holiday Sweets for Those Who Tweet

▶ **Chocolate makers tap the Internet to reach Gen Y shoppers**

▶ **The Web allows Lindt "to be far more accessible than it's ever been"**

Indulgent and affordable, chocolate is a popular gift during tough economic times. Two-thirds of U.S. adults buy chocolate during the holidays, according to researcher Mintel International Group. Americans will spend more than $200 million on gift boxes, predicts market tracker Nielsen. And the shoppers most likely to buy chocolate this season, Mintel says, are millennials aged 18 to 24, such as Daniel Killeen. The 23-year-old associate at a Boston venture capital firm plans to spend as much as $75 on Teuscher's Swiss chocolates for his mother and grandmother.

Trouble is, younger consumers are famously tricky for manufacturers such as **Kraft Foods**, **Nestlé**, and **Godiva** to reach via traditional marketing. That's pushing many chocolate makers—long content to pitch consumers through magazine ads or supermarket promotions—online in search of youth with a sweet tooth.

In June, Switzerland's **Lindt & Sprüngli** hired its first digital marketing manager, a **Panasonic** veteran named Kate Dickman, who chats with consumers and provides product updates (such

ILLUSTRATION BY ALEX EBEN MEYER. OPPOSITE PAGE, CLOCKWISE FROM TOP: PRNEWSFOTO/FIJI WATER/AP PHOTO; URBANO DELVALLE/TIME LIFE PICTURES/GETTY IMAGES; ADAM ROUNTREE/BLOOMBERG; STEPHEN SHAVER/BLOOMBERG

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as details on its new Lindor truffles) via a blog, Twitter feed, and **Facebook** page. "Lindt is allowing the brand to be far more accessible than it has ever been in the past," says Thomas Linemayr, chief executive officer of **Lindt USA**. New York boutique chocolatier **Jacques Torres** is also embracing the Web. Besides the usual social media tools, he'll soon debut a live video feed from his factories that he hopes will wow serious chocoholics.

Last year, **Yildiz Holding**'s Godiva Chocolatier showed that Web promotions can lure young buyers when it successfully launched a Facebook campaign featuring virtual chocolates that visitors could send to friends and family, says Chief Marketing Officer Lauri Kien Kotcher. When the recipient "opened" the cybergift, she and the sender were entered into a contest to win a free assortment of Godiva bonbons monthly for a year. Jenny Polledri, 23, a recent college grad in North Caldwell, N.J., says she usually doesn't endorse specific brands on Facebook but would "definitely" follow Godiva's page if it meant a year of free sweets. Godiva has also launched a loyalty program giving members samples and free shipping—popular draws for Gen Yers on tight budgets.

Chocolate makers are cutting prices, too. Nestlé's Wonka brand, based on the fictional chocolate factory owner, has a line of stocking stuffers priced from $3 to $5, with offbeat packaging that appeals to younger buyers and stands out in a sea of white rectangular boxes, says seasonal marketing manager Jeremy Vandervoet. He says millennials comprise a good chunk of the 780,000 fans of Nestlé's Wonka Facebook page.

New York's **La Maison du Chocolat**, which sells a $1,200 "Candy Cane Christmas Tree" that takes 18 hours to prepare, launched a Facebook page this season to encourage store visits. Michael Olsen, who runs the French company's Madison Avenue store, says about 30 percent of Maison's New York shoppers are under age 30. Many are students from Manhattan private schools who come for a chocolate fix after class. "We can talk about our chocolate until we're blue in the face," he says. "It's all about getting them into the stores to taste it." —*Matthew Boyle*

The bottom line *Chocolate, a popular holiday gift, is a winner with Gen Y consumers. To reach those younger buyers, confectioners are using the Web.*

Briefs

by Caroline Winter



Fiji Water
Shutting off the tap?

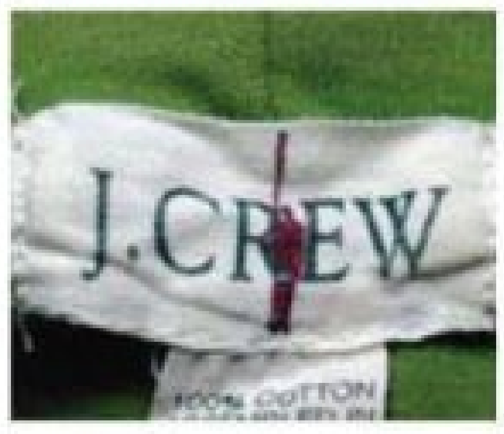
Fiji's military government on Nov. 18 expelled David Roth, the top local manager of Fiji Water, a company owned by Los Angeles billionaires Stewart and Lynda Resnick. The move comes amid rumors that Fiji may limit access to the aquifer that supplies the water. Roth's visa was revoked following the resignation of acting Prime Minister Ratu Ganilau, who left his post citing differences with the country's ruler, Voreqe Bainimarama, "over the David Roth issue," Pacific News Agency Service reports. Bainimarama has accused Fiji Water—which accounts for 20 percent of the island nation's exports—of selling to its U.S. parent at artificially low prices to avoid taxes, according to Agence France-Presse.

Chrysler
Big hopes for small-car makers

$15,500

Executives for the Smart and Mini small-car brands hope interest in subcompacts will heat up when Fiat's 500, with a $15,500 price, hits U.S. showrooms in January. Mini's U.S. sales are off by 1.6 percent this year, to 38,538, while sales of Smart's U.S. model, fortwo, have plummeted 61 percent, to 5,146. Small-car makers hope the increased competition will attract interest among American buyers. Chrysler, now owned by Fiat, will be in charge of marketing the 500.

J.Crew
Before Black Friday, a sale



J.Crew has agreed to be acquired by TPG Capital and Leonard Green & Partners for about $3 billion. The new owners say they will keep working with CEO Millard Drexler, the former Gap chief executive, who has doubled J.Crew's revenue to $1.6 billion, since taking over in 2003. On Nov. 23, however, the retailer lowered its full-year earnings forecast for the second time this year. Sales at J.Crew stores open at least one year dropped 1 percent in the quarter ended Oct. 30, while net income fell 14 percent.

Tesco
Playing catch-up in China



British retailer Tesco plans to quadruple its sales annually in China, to $6.4 billion, and increase its mainland stores from 88 to 200 in the next five years. Tesco is playing catch-up to rivals Wal-Mart and Carrefour, which entered China almost a decade earlier. Researcher Planet Retail estimates grocery retail sales in China will hit $969 billion this year. In September, Tesco revealed plans to develop 80 five-story Lifespace malls there, with movie theaters and restaurants. It is also stepping up expansion plans in India and South Korea.

KKR
Going to the dogs (and cats)



KKR is in advanced talks to acquire Del Monte Foods in a deal that would give the New York buyout firm pet-food brands such as Meow Mix, Kibbles 'n Bits, and Milk-Bone, according to two people familiar with the matter. Del Monte's pet food sales have more than doubled since 2006, to $1.75 billion, for the year ended May 2, making up roughly half the company's revenue. The move is part of an ongoing consolidation of the pet food industry. In September, Nestlé bought dog snack maker Waggin' Train. In May, Procter & Gamble, owner of Iams and Eukanuba, purchased Natura Pet Products.

On the Move

Apple Ex-Northrop Grumman CEO Ronald Sugar named director • **KeyCorp** Vice-Chair Beth Mooney to become CEO in May • **Airbus** Production chief Gerald Weber to resign in March 2011

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Politics & Policy



ABC's *Detroit 1-8-7* is shot in Michigan and subsidized by the state

MARK H. PRESTON/ABC/GETTY IMAGES

Strapped States Are No Longer Fans of Hollywood

▶ They're ending generous tax incentives designed to lure Hollywood film and TV productions

▶ "We are starting to stem the tide of state government pandering to the film industry"

The new prime-time **ABC** television show, *Detroit 1-8-7*, is giving the Motor City's famous restaurant, American Coney Island, a lift. Since the crime drama's first episode aired in September, featuring two TV cops munching on the landmark eatery's chili dogs, customers have been pouring in, says Grace Keros, the third-generation owner. "It's given the city a new buzz," she says.

What's good for the restaurant, however, hasn't been so great for Michigan taxpayers. The show's producers were lured by state incentives—a mix of tax credits, job-training subsidies, low-interest loans, and other aid. A state report says such subsidies are the most generous in the U.S., and cost Michigan taxpayers more than the economic activity they generate. The 355 full-time jobs created as a result of the program last year cost the state about $193,000 each, the study found. Rick Snyder, the Republican governor-elect, wants to curb the largesse.

Since 2005 states have granted $3.5 billion in incentives to makers of films, TV shows, and commercials, according to a Tax Foundation calculation for *Bloomberg Businessweek*. Now, as states face a total of $72 billion in budget deficits in their coming fiscal years, according to the National Conference of State Legislatures, some are concluding Hollywood gets a lot more than it gives.

Kansas and New Jersey have suspended their tax credits. Rhode Island has capped subsidies at $15 million annually, and Wisconsin's are set at a measly $500,000 a year. Arizona's program is set to expire on Dec. 31. Larry Brownell, head of the Association of Film Commissioners International, which represents 41 of the 42 states offering credits, predicts half the states will shelve their programs within a decade.

The film credits, which cover everything from housing, labor, and food to rental equipment and set construction, can be lucrative. Michigan's cover as much as 42 percent of a production's local costs. Such

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Politics&Policy

Motor City Movies



CONVICTION, released October 2010

In photo: Hilary Swank and director Tony Goldwyn

Filmed in: Ann Arbor, Detroit, Dexter, Jackson, and Ypsilanti, Mich.

Estimated tax credits: $4.2 million

Box office: $6.3 million domestic only (not released worldwide)

Economic benefit to Michigan: $2.4 million



GRAN TORINO, released January 2009

In photo: Clint Eastwood confers with crew and cast

Filmed in: Detroit, Grosse Point, Highland Park, Royal Oak, and Grand Rapids, Mich.

Estimated tax credits: $4.7 million

Box office: $270 million worldwide

Economic benefit to Michigan: $2.5 million



WHIP IT, released October 2009

In photo: Drew Barrymore in her directorial debut

Filmed in: Ann Arbor, Detroit, Novi, and Ferndale, Mich.

Estimated tax credits: $4.8 million

Box office: $16.6 million worldwide

Economic benefit to Michigan: $2.5 million

DATA: MICHIGAN SENATE FISCAL AGENCY, INTERNET MOVIE DATABASE, BOXOFFICEMOJO.COM

incentives have helped attract Hilary Swank's *Conviction*, Clint Eastwood's *Gran Torino*, George Clooney's *Up in the Air*, and 100-plus other films to Michigan.

After Wisconsin lawmakers slashed the state's tax credits, Green Bay native Tony Shalhoub of TV's *Monk* starred in ads sponsored by Wisconsin filmmakers asking legislators to reconsider. When Governor Chris Christie in New Jersey called off that state's 20-percent-of-costs rebates on July 1 in an austerity move, **NBC**'s *Law & Order: SVU* moved across the river to shoot in New York.

Tax analysts say it's about time Hollywood took a back seat to more pressing needs. "We are starting to stem the tide of state government pandering to the film industry," says Bill Ahern, policy director for the Tax Foundation, which advocates lower taxes.

The credits also have aroused criticism because some states make them refundable. That means a production owing little or no state taxes still gets a check for the portion of the tax breaks it didn't need. In Michigan and 13 other states the credits are also transferable and can be sold in a secondary market to companies looking to cut their own taxes. Often the transactions are secret. A Connecticut nonprofit's Freedom of Information Act request forced the state to reveal that **Bank of America, Wachovia, Hershey, Comcast, Provident Life & Casualty Insurance**, and **Colonial Life & Accident Insurance** had bought credits from filmmakers to lower their tax bills. Provident, Colonial, and Bank of America confirmed that they purchased the tax credits and declined to comment further. The other three declined to comment. "Outrageous," says Robert Tannenwald, a former vice-president at the Boston Federal Reserve Bank and now a senior fellow at the Center on Budget and Policy Priorities. "There's no reason for a government to finance a financial institution in such a circuitous way."



In Louisiana (which first offered Hollywood tax breaks in 1992), a film studio owner is set to be sentenced in January after pleading guilty to wire fraud in a scheme to sell $1.9 million in bogus credits to quarterback Drew Brees and other New Orleans Saints. A subsidy scandal hit Michigan in August when an investor in a planned Grand Rapids studio was charged with attempted fraud in applying for the state's 25 percent movie infrastructure credit. Iowa suspended its tax-credit program last year after two producers were charged with fraud.

Filmmaker Michael Moore attacked film tax credits in 2008, saying large corporations like **Viacom** were getting them. He now says the lures are important for Michigan because it's "so far down in the toilet" economically. A Flint native, Moore says he's using the $1 million state credit he received for last year's *Capitalism: A Love Story*—distributed by Viacom—to restore aging theaters around Michigan.

Some states are staying in the game. California began offering credits last year; New York just extended its program for five years; and Florida and Virginia recently enacted new enticements. "I think the states are recognizing that they are an economic stimulus," says Vans Stevenson, a senior vice-president of the Motion Picture Association of America.

An October poll shows Michigan voters like the movie subsidies, and it's no surprise, says economist David Zin. There's a certain thrill to having Drew Barrymore (who shot parts of her directorial debut, *Whip It*, in Michigan) take up residence, if only temporarily. But the total return in tax revenue has been a little more than 10¢ on each dollar spent, Zin says, adding that Michigan will probably get some $80 million in economic activity from productions—less than the $125 million the state will likely spend. "With that kind of money," Michigan State University economics professor Charles Ballard says, "we could have a citrus industry in the Upper Peninsula."

Carrie Jones, the Michigan Film Office director, says Zin's numbers don't tell the whole story and that it's too soon to judge the program's success. "We need a little more time," she says. Time may have run out.

—Tom Moroney, with Michael White

The bottom line *States are canceling subsidies used to lure Hollywood productions, which aren't creating enough jobs to justify the cost.*

CLOCKWISE FROM TOP LEFT: FOX SEARCHLIGHT; WARNER BROS./EVERETT COLLECTION; DARREN MICHAELS/MANDATE PICTURES; BILL CLARK/ROLL CALL/GETTY IMAGES; ALBERTO E. RODRIGUEZ/OVERTURE/GETTY IMAGES

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Congress

Climate Skeptics Storm the Capitol

▸ Cap and trade may be just the first casualty of climate-change doubters

▸ "Reasonable people have serious questions about...the science"

"I am vindicated," says Republican Senator James M. Inhofe of Oklahoma, who was ridiculed by environmentalists in 2003 when he declared that man-made global warming was the "greatest hoax ever perpetuated on the American people."

He has reason to crow: His party's sweep of the midterm elections will bring into office almost four dozen new lawmakers (11 senators and at least 36 House members) who share his skepticism about climate change, according to ThinkProgress, an arm of the Center for American Progress Action Fund, a Washington research group allied with Democrats. They join a smaller group of Republican incumbents, some of whom will assume powerful committee positions in January, who also reject that global warming is an immediate threat.

Their influence could be felt soon. When Obama Administration negotiators arrive in Cancun, Mexico, on Nov. 29 for 12 days of climate-change talks, they will no longer be able to claim that their policy agenda–to push for global action on climate change–has the full backing of Congress (page 59).

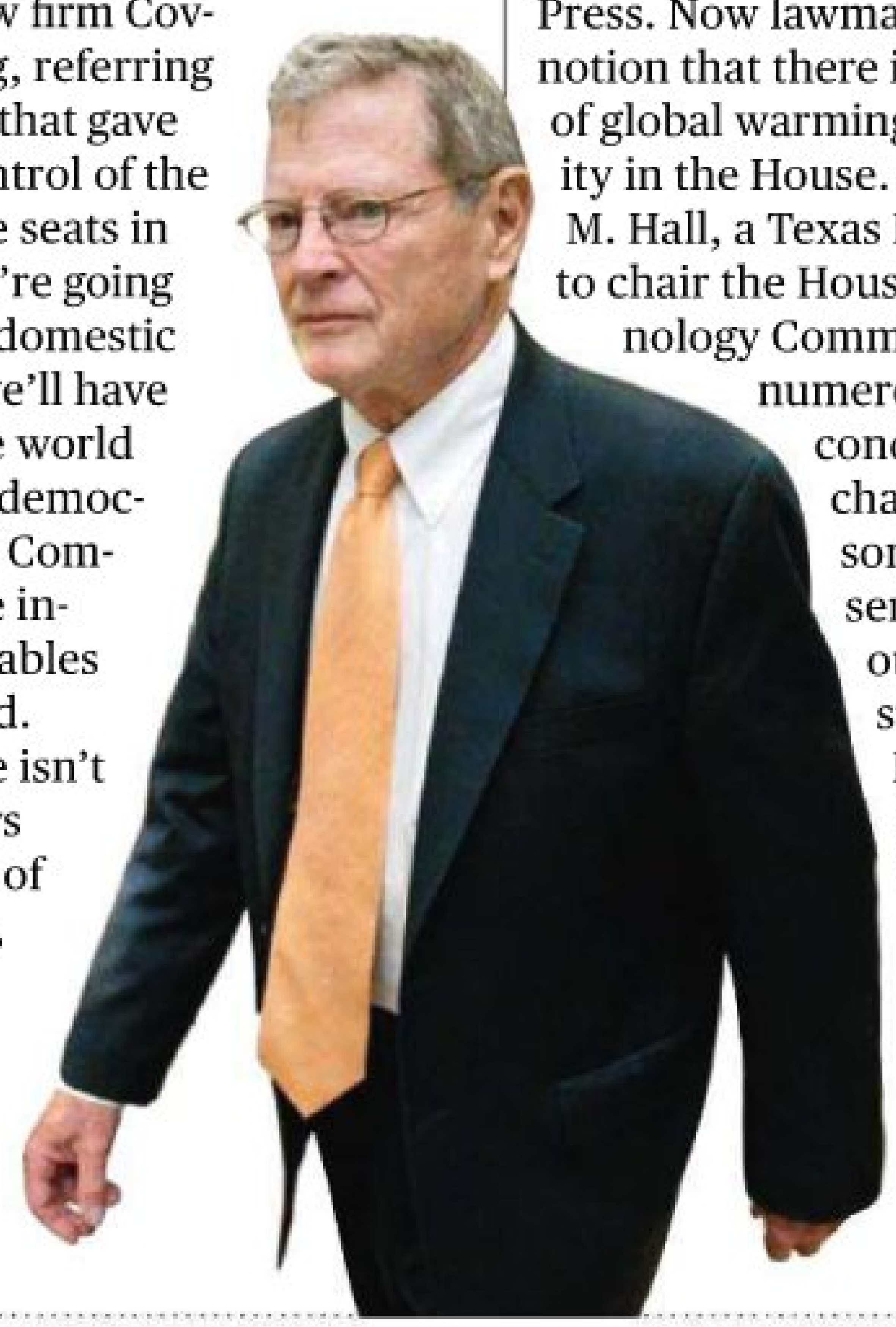
The day after the Nov. 2 elections, President Barack Obama acknowledged that the new balance of power requires him to scale back his environmental agenda. The President has all but scrapped plans for legislation that would require companies to buy and sell pollution allowances, a so-called cap-and-trade system. Even modest goals could be tough to realize. Republicans say they will seek to roll back Environmental Protection Agency rules, set to take effect in January, limiting carbon emissions, as well as restrictions on coal mining. They also may try to block billions of dollars in federal funds the Administration has directed to wind, solar, and other alternative sources, as well as electric-car technologies, areas Obama pitches as the manufacturing engines of the future.

"It's hard to spin that it's a good thing," says Gerard Waldron, a partner with Washington-based law firm Covington & Burling, referring to the elections that gave Republicans control of the House and more seats in the Senate. "We're going to focus on our domestic situation, and we'll have to explain to the world what American democracy looks like." Companies that have invested in renewables are disappointed. "Climate change isn't going away," says Lewis Hay, CEO of NextEra Energy, the largest U.S. producer of wind and solar energy. "We're going to have to take action sooner or later."

As an aide to Representative Edward Markey (D-Mass.), who heads a House panel on global warming, Waldron helped write cap-and-trade legislation. The House passed a bill in 2009, but it died earlier this year in the Senate. The bill's demise led the Chicago Climate Exchange, a voluntary U.S. carbon trading market acquired this summer for $600 million by Atlanta-based **IntercontinentalExchange**, to announce in October that it planned to shut down at yearend for lack of activity.

Meanwhile, the number of Americans who agree the earth is warming because of man-made activity has been in free fall, dropping to 34 percent in October, from 50 percent in July 2006, according to a poll by the Pew Research Center for the People & the Press. Now lawmakers who reject the notion that there is ironclad evidence of global warming are rising in seniority in the House. Representative Ralph M. Hall, a Texas Republican, is in line to chair the House Science and Technology Committee, which oversees numerous federal agencies conducting climate-change research. "Reasonable people have serious questions about our knowledge of the state of the science," Hall says. Representative John Shimkus of Illinois is vying to become chairman of the powerful House Energy and Commerce Committee. At a March 2009 hearing, ➔

Senator James Inhofe, a longtime climate-change skeptic, will soon be far less lonely in Washington. At least 47 incoming Republicans deny that science proves human activity is warming the planet.



The Climate-Change Casualty List

The incoming class of House and Senate Republicans include at least 47 who deny that scientific data prove human activity is warming the planet. Here's how they may complicate the Obama Administration's climate-change agenda:

Mandatory Cap-and-Trade Program

Already on life support, legislation to create a market for carbon emissions is now considered dead in the next Congress.

Voluntary Carbon Trading

The Chicago Climate Exchange announced in October it would shut down a voluntary carbon-trading market at the end of the year after determining that it was unlikely Congress would force emissions cuts.

Environmental Protection Agency Rules

Republicans and coal-state Democrats could team up to pass legislation to stop or slow down EPA rules that would force power plants and large factories to cut greenhouse gas pollution.

Climate-Change Oversight

Representative Darrell Issa (R-Calif.), incoming chairman of the House Oversight and Government Reform Committee, plans to investigate how EPA's clean-air rules may affect the economy.

Stimulus Funds

Republicans may try to rescind the $23 billion in stimulus funds that have yet to be spent by the Energy Dept. and curtail R&D subsidies for solar, wind, and electric cars and batteries.

DATA: BLOOMBERG, ENERGY DEPT.

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he said the Bible teaches that climate change won't destroy the planet.

Such statements could make it more difficult for the U.S. to convince other countries that it can meet its goal, pledged a year ago in Copenhagen, of cutting emissions to about 17 percent below 2005 levels by 2020. The U.S. will join about 190 countries in Cancun for U.N.-led talks aimed at drafting a new treaty. Obama's lead negotiator, Todd D. Stern, has said the U.S. will stand behind the target. It's probably a waste of time, says Inhofe. With Congress unlikely to adopt any carbon limits, negotiators will have little to do "other than swim," he says.

The U.S. insists it will reduce emissions by raising fuel-efficiency standards and through EPA regulation. The new Congress, however, could vote to delay the EPA rules or prohibit the agency from spending any money to implement them, which would have the same effect. With 9.6 percent unemployment, now is not the time to put new conditions on business, says Representative-elect Joe Walsh (R-Ill.), a skeptic. "We can't be put in a position where we are going to rush headlong into a policy that is going to tax our businesses and our families," says Walsh, a Tea Party favorite.

—Jim Snyder and Kim Chipman

The bottom line *Numerous global-warming skeptics taking office in the next Congress will try to undo President Obama's environmental initiatives.*

Government Motors

A Good Day For Obama's Auto Bankers

▸ The GM initial stock offering was a nail-biter for two men at Treasury

▸ The officials "passed with flying colors," says one finance professor

Want to underwrite one of the largest initial public offerings in history? Chop your usual fee by three-fourths and commit to limiting Wall Street's windfall.

That was the deal David Miller and Tim Massad, the unheralded government architects behind the General Motors stock offering, gave investment banks interested in handling the deal. When the two Treasury Dept. officials made their expectations clear, "we could kind of hear their jaws drop over the phone," says Massad.

Massad, acting assistant secretary for financial stability, and Miller, chief investment officer for the Troubled Asset Relief Program, were President Barack Obama's dealmakers on the Nov. 17 sale of GM stock, along with two Obama aides—manufacturing czar Ron Bloom and economic adviser Brian Deese.

The IPO, led by JPMorgan Chase and Morgan Stanley, was a nail-biter for Massad and Miller, who also manage the government's bank and insurance company investments. As Miller says, "you want the deal to go well" without looking overly optimistic in pricing the shares. "At the same time, we don't want it to go up way too much" because that would mean taxpayers left money on the table on the first day of trading.

GM's shares, initially priced at $33, rose 3.6 percent on Nov. 18, the first day of trading—exactly the "sweet spot" Miller and Massad wanted. Of the nearly $20 billion raised, almost $12 billion went to the U.S. Says Jay Ritter, a finance professor at the University of Florida in Gainesville who studies IPOs: Treasury officials "passed with flying colors."

Taxpayers, however, haven't broken even on GM. The government needed to sell its entire stake for about $44 a share for that to happen. The U.S. would need to sell its remaining 37 percent ownership of GM at $53 a share for taxpayers to be made whole.

Miller and Massad say they aren't waiting for the stock to reach that level. "We're not a private equity fund," Massad says. "We believe that promoting financial stability means we should exit as soon as we can." Of the $50 billion the government gave GM in 2008 and early 2009 when the auto industry was near collapse, Treasury says it will recover $9.5 billion through interest, loan repayments, and preferred stock dividends. Ultimately, the government may lose $5 billion to $7 billion of the $85 billion auto industry rescue effort,



One of the trickiest parts of the GM deal for Treasury's Miller (left) and Massad: Setting a fee that would entice Wall Street banks yet ensure they didn't profit at taxpayers' expense.

CLOCKWISE FROM TOP: BERTRAND LANGLOIS/AFP/GETTY IMAGES; JOSHUA ROBERTS/BLOOMBERG; ANDREW HARRER/BLOOMBERG; DATA: TSA

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As Thanksgiving drew closer, the backlash over pat-downs grew louder

Steven Rattner, former head of the President's auto task force, said in a Nov. 17 Bloomberg Radio interview.

Investment banking fees were one of the trickiest parts of the deal, says Herb Allison, the former Fannie Mae and Merrill Lynch executive who led Treasury's financial stability office from June 2009 through September 2010. If the government were too soft on the investment firms, Wall Street would profit at taxpayer expense. If too strict, the best firms might walk away. "That was a difficult decision," Allison says of Treasury's demand for a 0.75 percent fee. "I think it proved to be the right one."

Massad, 54, is a former corporate lawyer at Cravath, Swaine & Moore who has worked on hundreds of IPOs, although this is his first one as the client. He earned undergraduate and law degrees from Harvard. Miller, 34, worked on deals in Goldman Sachs Group's special situations unit, laying the groundwork for his job managing TARP's complex mix of preferred shares, common stock, warrants, guarantees, and dividend agreements. Before going to Harvard Business School he studied economics at Dartmouth, where he also minored in film studies.

The pair's labors aren't over yet. They still need to manage the rest of the government's auto stake, along with its holdings in American International Group, Citigroup, and hundreds of smaller institutions. "We have responsibility for almost $200 billion of assets and only one of those, which is very important, is General Motors," Miller says. "While it would have been nice to spend the day watching and feeling good about it, there was other business to attend to."

—Rebecca Christie and Ian Katz

The bottom line *Two Treasury officials, both former Wall Streeters, were the government's invisible hand behind GM's successful stock offering.*

Transportation

Close Encounters of The Security Kind

▶ **TSA's John Pistole is grappling with a public insurrection**

▶ **"This story has legs that it probably shouldn't have"**

Before the Transportation Security Administration tested a new plan to subject passengers at airports in Boston and Las Vegas to all-body pat-downs last summer, aides urged the agency's new chief, John S. Pistole, to alert the public. He declined. Doing so, he recalled months later, would have tipped off terrorists that similar body searches weren't being done at 451 other U.S. airports. "That gives an opportunity for somebody with bad intent," Pistole said in a Nov. 19 interview.

That decision helped spark the backlash that erupted this month, when thorough pat-downs began nationwide for travelers who decline body scans or trigger metal-detector alarms. The result was a Thanksgiving week, one of the year's busiest for air travel, that may be remembered not for family gatherings, turkey, and yams but as a season of rage over the indignity of intrusive pat-downs by TSA agents.

The lack of public education "has been a downfall," says Jeffrey Sural, a lawyer with Washington law firm Alston & Bird and a former TSA assistant administrator. "This story has legs that it probably shouldn't have." The insurrection has spawned a folk hero, John Tyner, the "Don't Touch My Junk" man, whose resistance became a viral Internet sensation. In Congress, Senator George LeMieux, a Florida Republican, said at a hearing on Nov. 17 that he wouldn't want his "wife to be touched in the way that these folks are being touched." Even Secretary of State Hillary Clinton said on **CBS**'s *Face the Nation* on Nov. 21 that she would be none too pleased if she had to submit to the new procedure.

The pat-down uproar may owe something to Pistole's background. Before taking the post five months ago, he spent 26 years at the FBI, where he led counterterrorism efforts after the September 11 attacks and rose to deputy director of the bureau in 2004. He participated in the probes of the attempt by a man carrying explosives in his underpants to bring down a passenger plane on Christmas Day, 2009, and the attempted bombing in May in New York's Times Square.

The Obama Administration was attracted to Pistole's law enforcement résumé as it searched for a credible TSA head. The post had been vacant for more than a year after two previous nominees withdrew. Pistole (pronounced pistol) even looks the part: A rangy man who sits ramrod straight and stands 6-foot-3, he could play the G-Man in a Hollywood production.

400

Number of body scanners now in service at 70 U.S. airports

Pistole, 54, acknowledges he may have fallen short in the customer-relations department. "We can do better," he said in the interview. Wrestling with his inner G-Man, Pistole said he is carefully considering a demonstration of pat-down procedures for the press. "If we demonstrate exactly what we're doing, is that again a road map to the terrorists?"

His challenge now is persuading the public to accept that the invasive searches are for their own good and that the policy is the result of better intelligence gathering, rather than a desire to harass travelers. "Look, I recognize it's


Pistole

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Extreme customer loyalty page 39 ▶



uncomfortable," Pistole said. "We have to make sure that we are providing the best security while trying to afford the best privacy, and there's a dynamic tension there." —*John Hughes*

The bottom line *The new head of the TSA is caught in a national uproar over the right balance between protecting travelers' privacy and their security.*

Financial Regulation

Geithner's Derivatives Dilemma

▶ **Banks want currency derivatives exempted from oversight**

▶ **"I urge Treasury not to create a potentially dangerous loophole"**

Treasury Secretary Timothy Geithner is in a difficult spot. Last year, as Congress was negotiating what became the Dodd-Frank financial-reform law, he sought to exclude foreign exchange derivatives from new regulations. Gary Gensler, the Commodity Futures Trading Commission chief and soon-to-be-regulator of derivatives, opposed the move. Congress split the difference by including currencies but also giving Geithner the authority to study the instruments and decide whether to exempt them.

Now a coalition of 20 companies, including **Deutsche Bank**, **Bank of New York Mellon**, and **UBS**, is pushing Geithner to give currency derivatives a pass from oversight. They argue that foreign exchange is less complex than other derivatives and played no role in the financial crisis, unlike the credit default swaps that brought down **American International Group**.

At $42 trillion, currency swaps and forwards–the types of derivatives in question–make up the second-largest over-the-counter derivatives market after interest-rate swaps. "This is the ultimate unregulated market," says Bill Brown, a professor at Duke University School of Law who once oversaw exchange-traded derivatives at **Morgan Stanley**. "You'd better believe if you leave the currency markets totally unwatched they will probably be one of the places that blow up next," says Brown, who thinks both sides have valid arguments.

Currency derivatives are contracts that allow importers and exporters to lock in favorable rates when they must convert funds from one currency to another. **Ford Motor** used them to protect profits on U.S.-made F-Series trucks sold in Mexico and Canada, Neil M. Schloss, vice-president and treasurer at Ford, testified to Congress in November 2009. Hedge funds and other investors also use them as speculative instruments.

The banks warn that new rules would drive trades offshore and could even threaten the Federal Reserve's ability to set monetary policy. During the congressional debate, the Fed agreed that currency derivatives should be exempted. U.S. commercial banks recorded $4.3 billion in second-quarter revenue from trading of foreign exchange derivatives, according to the U.S. Office of the Comptroller of the Currency. While 85 percent of foreign exchange transactions involve the U.S. dollar, only 18 percent of dollar-based trades are handled in the U.S. Britain holds the biggest market share, with 37 percent.

The banks' opponents say an exemption would open a giant gap in the new law. "I urge Treasury not to create a potentially dangerous loophole," says Senator Maria Cantwell (D-Wash.). She agrees with Gensler, who last year wrote to lawmakers that Treasury's proposed exemption threatened to "swallow up the regulation." Gensler declined to comment further.

Now Geithner must find a way to satisfy lawmakers and regulators without disrupting the market or causing job losses if banks move traders offshore. Signed by President Barack Obama in July, the Wall Street reform law requires most derivatives to be traded on an exchange or through a clearinghouse, where the parties would be required to post collateral. The idea is to make the process more transparent and guarantee the trades can be settled in an orderly fashion, thus reducing the risk that excessive speculation or trades gone bad threaten the entire financial system.

Even if Geithner agreed to exclude currency derivatives from regulation, banks would still have to report information about their trades to new central databases. Treasury is accepting public comment until Nov. 29 and notes that Geithner hasn't decided whether an exclusion is warranted. Ⓑ

—*Robert Schmidt and Silla Brush*


The bottom line *Geithner is caught between bankers and regulators on how much oversight to give currency derivatives.*

CLOCKWISE FROM TOP: JUDITH COLLINS/ALAMY; ANDREW HARRER/BLOOMBERG; BRENDAN HOFFMAN/GETTY IMAGES

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the definition of insanity is doing the same thing over and over again and expecting different results.

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Technology

What's in the Box? Instant Gratification



▶ Customers love Prime, Amazon's two-day shipping program. Now rivals are copying it

▶ "Amazon is an existential threat, and Prime is the fuel of the engine"

Ruth Tinsley made two momentous changes to her life in the last year. In December she had identical twin girls. A few weeks later she signed up for **Amazon.com**'s free shipping service, Amazon Prime, which guarantees delivery of products within two days for an annual fee of $79. The combination of those two events turned the graphic designer from Birmingham, Ala., into an Amazon loyalist who now buys software, jewelry, and birthday gifts on the site. Her 2010 Amazon total heading into the holidays: 150 individual items, up from 82 in all of 2009. "Now if I see or hear about a product somewhere else, I'll always check first to see if Amazon has it," Tinsley says.

Amazon Prime may be the most ingenious and effective customer loyalty program in all of e-commerce, if not retail in general. It converts casual shoppers like Tinsley, who gorge on the gratification of having purchases reliably appear two days after they order, into Amazon addicts. Analysts describe Prime as one of the main factors driving Amazon's stock price—up 296 percent in the last two years—and the main reason Amazon's sales grew 30 percent during the recession while other retailers flailed. At the same time, Prime has proven exceedingly difficult for rivals to copy: It allows Amazon to exploit its wide selection, low prices, network of third-party merchants, and finely tuned distribution system, while also keying off that faintly irrational human need to maximize the benefits of a club you have already paid to join.

Some analysts estimate Prime may be responsible for up to 20 percent of Amazon's U.S. sales

Now six years after the program's creation, rivals, both online and off, have sensed the increasing threat posed by Prime and are rushing to

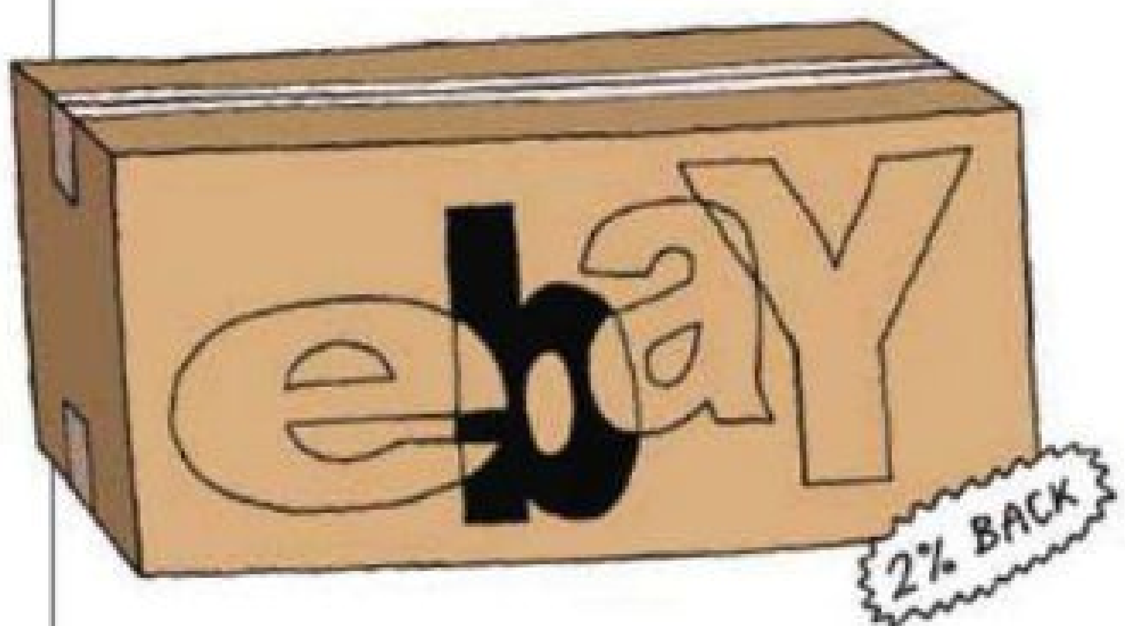
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Technology

try to respond. **Wal-Mart Stores**, **Best Buy**, **Target**, and **J.C. Penney** have recently unveiled free shipping promotions for the holidays, turning the fall shopping season into a race to see who can go furthest in lowering shipping costs. In August, eBay announced



its first rewards program, eBay Bucks, which gives shoppers 2 percent back on items purchased on the auction site using PayPal. Last month a consortium of more than 20 retailers, including **Barnes & Noble**, **Sports Authority**, and **Toys 'R' Us**, banded together with their own copycat $79, two-day shipping program, ShopRunner, which applies to products across their Web sites. "As Amazon added more merchandising categories to Prime, retailers started feeling the pain," says Fiona Dias, executive vice-president at **GSI Commerce**, which administers the ShopRunner service. "They have finally come to understand that Amazon is an existential threat and that Prime is the fuel of the engine."

Amazon relentlessly promotes Prime in press releases and on its home page, and this year started offering free Prime trials to students and parents. The company declines to disclose specifics about the program, though analysts estimate it has more than 4 million members in the U.S., a small slice of Amazon's 121 million active buyers worldwide. Analysts say Prime members increase their purchases on the site by about 150 percent after they join and may be responsible for as much as 20 percent of Amazon's overall sales in the U.S. The company's executives acknowledge only that the program gets people to buy more—and more kinds of items—on the site. "In all my years here, I don't remember anything that has been as successful at getting customers to shop in new product lines," says Robbie



Schwietzer, vice-president of Amazon Prime and an eight-year veteran of the company.



Prime came to life in late 2004, the result of a years-long search at Amazon for the right loyalty program. An Amazon software engineer named Charlie Ward first suggested the idea of a free shipping service via a suggestion box feature on Amazon's internal Web site, according to Ward's colleagues at the time. Bing Gordon, an Amazon board member and venture capitalist, says he came up with the "Prime" name, while other executives, including Chief Executive Jeffrey P. Bezos himself, devised the free two-day shipping offer, which exploited Amazon's ability to accelerate the handling of individual items in its distribution centers.

According to several former employees who participated in the program's creation, Bezos commissioned Prime in December 2004 at an unusual Saturday meeting in the boathouse behind his home in Medina, Wash. At the meeting, he told the small team of employees they could commandeer other company engineers and resources, and instructed them to ready Prime for a rollout in time for the company's fourth-quarter earnings report in January, less than two months away. The program is a "big idea," Bezos told the group that day in the boathouse, according to people who were there, and one that would help the company further capture the devotion of its best customers.



Bezos met with the group three times a week during that span. When the team members said they could not make the deadline, Bezos, eager to take advantage of the free publicity from earnings announcements, delayed the report by a week. One challenge was selecting the annual fee for the service; there were no clear financial models because no one knew how many customers would join or how it would affect their purchasing habits. The team ultimately went with $79 mainly because it's a prime number. "It was never about the $79 dollars. It was really about changing people's mentality so they wouldn't shop anywhere else," says Vijay Ravindran, who worked on the Prime team and is now chief digital officer for *The Washington Post*. After the in just three months, not the two years the team had originally forecast. The results "blew us away," says Jeff Holden, who led the team and now runs Pelago, a startup that makes a mobile phone game called Whrll.

Amazon now offers Prime in the continental U.S, Britain, Germany, France, and Japan, and Schwietzer says the company is moving toward guaranteeing Prime shipments within a day instead of two days. Analysts are divided on whether the free shipping offers from Wal-Mart and others will affect Prime. Some point to the fact that these offers will expire after Christmas and do not guarantee two-day delivery, and say consumers will find Prime the better deal. Others, like Gene Munster at Piper Jaffray, think shoppers will think twice about paying that $79, at least for now. "Free shipping does undermine Prime," Munster says. "Wal-Mart made every person in America a Prime user overnight."

Another debate among Amazon analysts and customers is whether Prime is actually worth the money. Many members swear by the service and evangelize about it—Ruth Tinsley says she has gotten several friends to join. Others question whether Prime is really a good deal, since Amazon usually offers free shipping when customers buy more than $25 worth of items at a single time. The company now reliably ships to certain parts of the country such as New York and San Francisco within a few days and at no extra charge.

"I don't think it's a bargain at all," says Kit Yarrow, a professor of psychology and marketing at Golden Gate University who recently got a free Prime trial and cancelled it after a month. "Really what people are paying for is immediate gratification." —*Brad Stone*

***The bottom line** Wal-Mart and others want to replicate the success of Amazon Prime, which has boosted customer loyalty and sales at the e-tailer.*

ILLUSTRATION BY PETER ARKLE; EINHORN: PHOTOGRAPH BY DOROTHY HONG FOR BLOOMBERG BUSINESSWEEK

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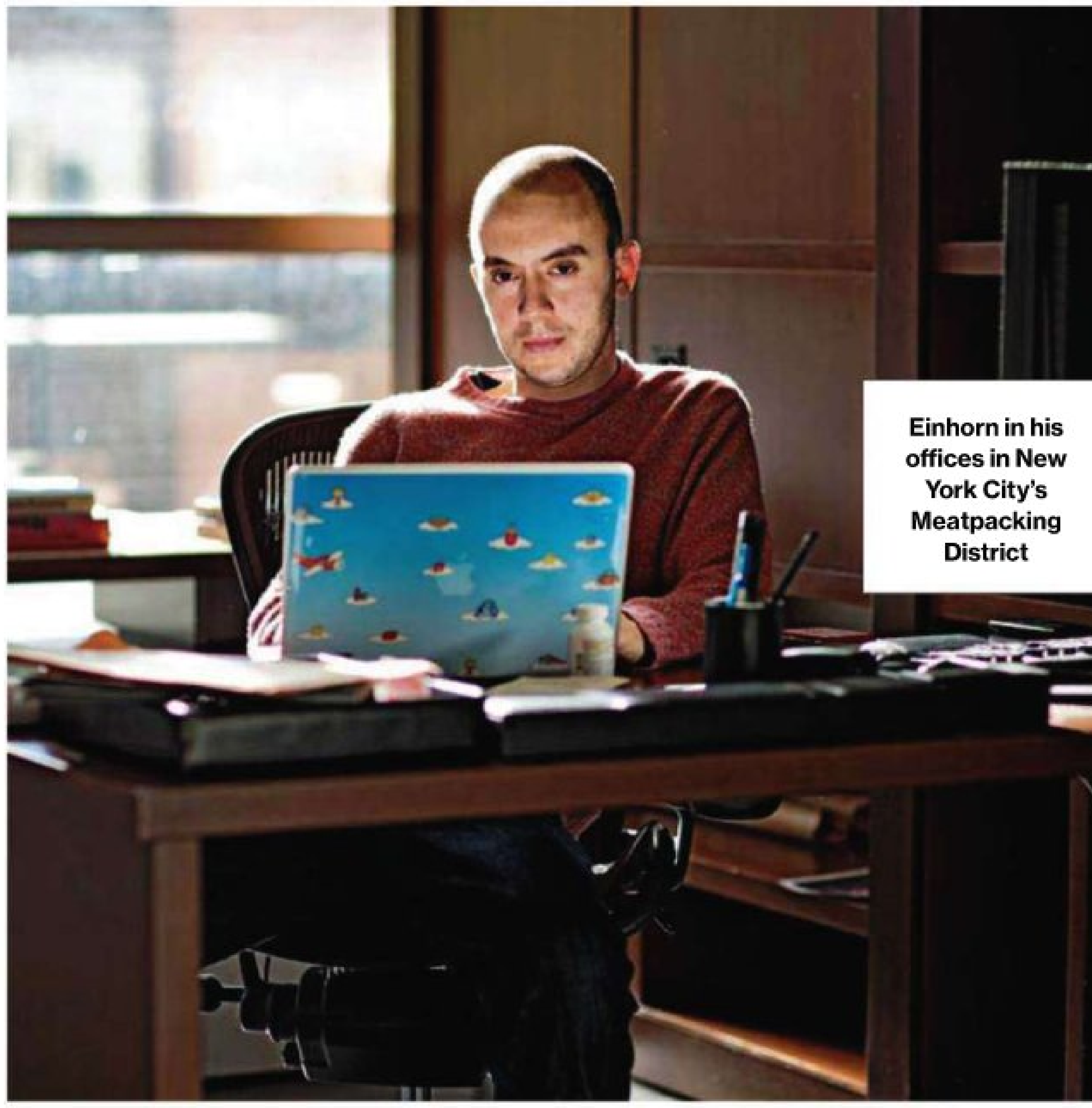
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Databases

A Web Site for the World's Materialists

▶ NYC startup Thingd is categorizing every product and object

▶ "I want to be able to keep track of the stuff that I have in my life"



Einhorn in his offices in New York City's Meatpacking District

Web entrepreneur Joseph Einhorn's new site, The Fancy, is about what it sounds like: a collection of beautiful stuff. It's an invitation-only photo blog where more than 5,000 tastemakers and celebrities upload and tag images of their possessions, as well as the baubles they'd like to own. Actor Ashton Kutcher showed off a Leatherman multitool the other day; the magician David Blaine recently added an image of a Leica M9 camera.

It's a simple concept, and a window onto Einhorn's complex goal of building an online "catalogue of everything in the world," as he puts it. The Fancy is the outward face of **Thingd** (pronounced Thing D), the company Einhorn, 29, founded in June 2009. "Where **Google** is an index of websites, and **Facebook** is a database of people, we want to be the database of everything," he says.

Thingd is backed by a who's who of investors, including venture capital firm **Andreessen Horowitz**, investment bank **Allen & Co.**, and **MTV** founder Bob Pittman. **Twitter** creator Jack Dorsey and Facebook co-founder Chris Hughes sit on the board. They're betting that Einhorn, a New York City native who joined the financial information company Capital IQ at age 16 and built much of its technology, can mint money out of data once again. (**Standard & Poor's** acquired Capital IQ for more than $200 million in 2004.)

Thingd's computer servers constantly crawl tens of thousands of product-rich websites, such as **J. Crew** and **Best Buy**. When the program comes across an unfamiliar object—whether it be a shoe or a stapler or a truck—it collects an image, extracts whatever related facts it can find, and then adds the item to the database. So far, the crawler has identified more than 100 million items, and it aims for as much specificity as possible—a white 1999 Ford Explorer, for instance, rather than just an SUV. The Fancy is a crowdsourced supplement. When people upload photos to The Fancy, says Einhorn, "they're just training our database." The database becomes smarter over time—once it's seen several pictures of, say, a chandelier, it starts to recognize the same chandelier in other pictures, even when no identifying information is available.

Thingd plans to turn its data into revenue by raking in affiliate fees, the small sums retailers like **Amazon.com** pay Web sites when they refer visitors that end up making purchases. Einhorn hopes to partner with media websites such as Vogue.com, which could use Thingd's technology to automatically identify products in photos and provide information about them to consumers. Thingd would share the affiliate fees if links lead to a purchase. The company could also help private buyers and sellers of secondhand goods find each other and take a cut of the transactions (á là eBay).

Every time someone uploads a photo to The Fancy, "they're just training our database"

Thingd has built an iPhone app for The Fancy and plans to open the stylish playground to the masses within the year. Board member Hughes says that despite being a "really simple" website and invitation-only at the moment, The Fancy "is moving through Twitter, moving through Facebook, and moving through blogs at the rate that you like to see." Sasha Charnin Morrison, the fashion director at *Us Weekly*, says it's a hit with her staff: "We love the presentation of it." Hughes suggests that the success of location-tracking applications like Foursquare and social networking sites proves that there's an audience for The Fancy. "If I can keep track of where I am physically in a city and if I can keep track of what my friends are doing," he says, "then I want to be able to keep track of the stuff that I have in my life."

Thingd isn't the only company to spot this opportunity. "The field of entity tagging is exploding," says Roger Ehrenberg, a New York City-based venture capitalist. Other startups, he

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The exit door opens for buyout firms page 49 ▶

says, are also working to categorize real-world objects. Einhorn says he's thrilled by the competition because it means Thingd is at least playing the right game. An online catalogue of stuff is "going to happen," he says. "The question is, 'Can we be there?'" —*Ira Boudway*

***The bottom line** Thingd is categorizing the world's stuff, and plans to make money off affiliate fees and transactions of secondhand goods.*

Acquisitions

So Google's Buying Your Startup. Now What?

▶ The company's M&A chief has to persuade founders to stick around

▶ "It can be very challenging to work in a company the size of Google"

You'd think David Lawee has it easy. He's the mergers-and-acquisitions chief for **Google**, a company with $33.4 billion in cash and a willingness to spend it. The search giant's pay is good and its perks are legendary, so persuading scrappy startups to sell for multimillion-dollar sums should be a cinch. But Google's stock is past its days of heady growth, and hotter rivals like **Facebook** are making deals of their own, so Lawee still has to work hard. Entrepreneurs want to know: Why sell to Google? And why stick around once the check clears?

Google has stepped up its dealmaking this year, spending $1.6 billion on more than 20 companies through September. In an interview earlier this month, Lawee said he sees "more large opportunities" for purchases on the order of **YouTube** and **DoubleClick**, Google's two largest deals. Google now is in talks to acquire social shopping site **Groupon** in a deal that could be the search company's most expensive acquisition ever, say two people with knowledge of the matter.

As it makes deals, Google is seeking more than just advanced technology. The company also hopes to add to its ranks seasoned entrepreneurs who can be molded into star executives. Recently, some of those would-be stars have blinked out. Omar Hamoui, founder of mobile-ad startup **AdMob**, left Google in late October, just five months after the roughly $700 million purchase of his company was completed. YouTube founder Chad Hurley and Lars Rasmussen, whose Where 2 Technologies was acquired in 2004 and became the basis for Google Maps, both announced their departures in the past month. (Hamoui, Hurley, and Rasmussen all were unavailable or declined to comment for this story.) Rasmussen told the *Sydney Morning Herald* in November that "it can be very challenging to be working in a company the size of Google."

Lawee says such high-profile departures are not indicative of Google's track record. Two-thirds of the founders of startups acquired by Google remain with the company, he says. Joshua Schachter, a serial entrepreneur who sold a company to **Yahoo!** in 2005 and then worked at Google until June of this year, says the search company's retention rate compares favorably with that of many of its competitors. "Elsewhere, I've seen that entrepreneurs tend to bail because the things that drive [them] are at odds with the way companies are run," he says.

Google also faces a challenge in winning over founders in the first place. Competitors like Facebook and **Apple** are in acquisitive moods as well. The social networking site has made eight deals so far in 2010. Apple Chief Executive Officer Steve Jobs said in October that he's reserving his company's $51 billion in cash and investments for "one or more very strategic opportunities [that] may come along."

In inking deals, it helps that Google's chief negotiator doesn't look like a suit.





Tweeted

"Dear Chinese Government, yearlong detentions for sending a sarcastic tweet are neither the way forward nor the future of your great people."
—Twitter CEO Dick Costolo, after China imprisoned an activist for using the micromessaging service to mock nationalistic youths



At 44, Lawee is lean and youthful, and often arrives at meetings with a backpack. He is an entrepreneur himself and co-founded gaming site Xfire, which **Viacom** bought in 2006, the year after Lawee joined Google. "He's got this laid-back style that says, 'I like you, you like me—one way or another, we're going to work this out,'" says Anthony McCusker, an attorney at Goodwin Procter who represented AdMob during its negotiations with Google.

One of Lawee's pitches to potential acquirees is that they'll make a bigger impact on the world at Google than they could as an independent startup. "It's not financial retentions" that keep entrepreneurs at Google, he says. "They are motivated to change the world."

Google gives some of its acquirees elevated roles that go far beyond overseeing the products they created. Jonathan Sposato, who has sold two companies to Google—Phatbits, a publishing tool, in 2005 and Picnik, an easy-to-use photo editor, in July of this year—became product manager for the photos group after his latest sale. The new position put him in control of Picasa, a Google photo site used by more than 1.6 million people. The entrepreneur says that played a big part in his decision to sell Picnik to Google. The mission became "make the photo experience be better than it is today'" rather than a narrow focus on a single product, he says.

Google also promises founders room to take risks, says Noam Lovinsky, who sold video publishing tool **Episodic** to Google in April. When Episodic launched as a small startup in 2009, Lovinsky wanted to focus on building a simple-to-use tool that let professional ➜

CLOCKWISE FROM TOP: DAVID ROBERTSON/ALAMY; KIM WHITE/BLOOMBERG; ILLUSTRATION BY ANDY FRIEDMAN

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I DIDN'T
GET FORCED.
I GOT...

Microsoft
Dynamics CRM Online

DON'T GET FORCED.
GET WHAT FITS.

video producers upload and track the performance of clips. Instead, he found himself too focused on paying the bills. "There were a lot of things we had to wait on doing because we had to fund our road map," he says. At Google he "can worry about revenue at the right time to worry about revenue," he says. Whether that freedom helps persuade Groupon to agree to a sale is still an open question. —*Douglas MacMillan, with Peter Burrows and Brian Womack*

The bottom line *When Google buys a company, it offers financial incentives and expanded roles to founders it wants to shape into star executives.*

Machine Tools

How a Secretive Giant Ate an Industry's Profits



▶ Fanuc's controllers dominate the machine tool business

▶ "They're expensive and have a monopolistic attitude"

At the biennial Japan International Machine Tool Fair, manufacturers show off the equipment that makes up the guts of the industrial economy. During this year's show, which ended on Nov. 2, more than 800 companies displayed tools such as a box the size of a minivan that sculpts titanium for jet engines, a lathe that carves copper wire into microscopic pins used to test chip circuitry, and a milling machine that turns stainless steel into iPhone cases.

The tools were dizzyingly diverse, yet many had one thing in common: Their brains—the computers that control them—come from a secretive maker of robots and industrial automation gear named **Fanuc**. Researcher Arc Advisory Group estimates that some 60 percent of the world's precision machine tools use Fanuc's controls, which give lathes,

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grinders, and milling machines the agility to turn metal into just about any manufactured product. Fanuc's equipment "is so user-friendly. I love it," says Jared Moschkau, a Boeing machinist who uses a milling machine with Fanuc controls to sculpt 747 parts. "My co-workers all say the same thing."

Fanuc's paying customers–the makers of machine tools themselves–are not so enamored of the company. With its dominant market share, Fanuc charges a premium for its controls, skimming off much of the tool industry's profit. The company posted an operating margin of 44 percent last quarter while many of its customers barely broke even. "They're expensive and have a monopolistic attitude," said Philippe Selot, a salesman with Swiss manufacturer **Fritz Studer** at the Tokyo fair, displaying a $500,000 grinder used to make anything from gears to hip implants. His company uses Fanuc controls on all its machines. "As a customer, you feel powerless," he says.

Fanuc's headquarters, a sprawling complex in a forest on the slopes of Mount Fuji, looks like something out of a sci-fi flick. Workers in yellow jumpsuits with badges on their shoulders trot among yellow buildings as yellow cars hum along pine-lined roads. Fanuc lore holds that the founder, Seiuemon Inaba, believed yellow "promotes clear thinking." Inside the compound's windowless factories, an army of (yes, yellow) robots works 24/7. "On a factory floor as big as a football field you might see four people. It's basically just robots reproducing themselves," says Morten Paulsen, an analyst at CLSA Asia-Pacific Markets.

Outsiders are rarely allowed inside the facility, and workers not engaged in research are barred from labs. "I can't even get in," quips a board member who asks that his name not be used. Employees say e-mail is banned except on a handful of terminals, and most business is done by phone and fax. "We don't want data going out or viruses coming in," says Kazuaki Shinozuka, one of a swarm of yellow-clad Fanuc salesmen at the machine tool trade show.

The company doesn't have an investor relations department, never meets investors one-on-one, and doesn't have conference calls with analysts. Those who want information must trek to the remote campus, two hours west of Tokyo, where President Yoshi-



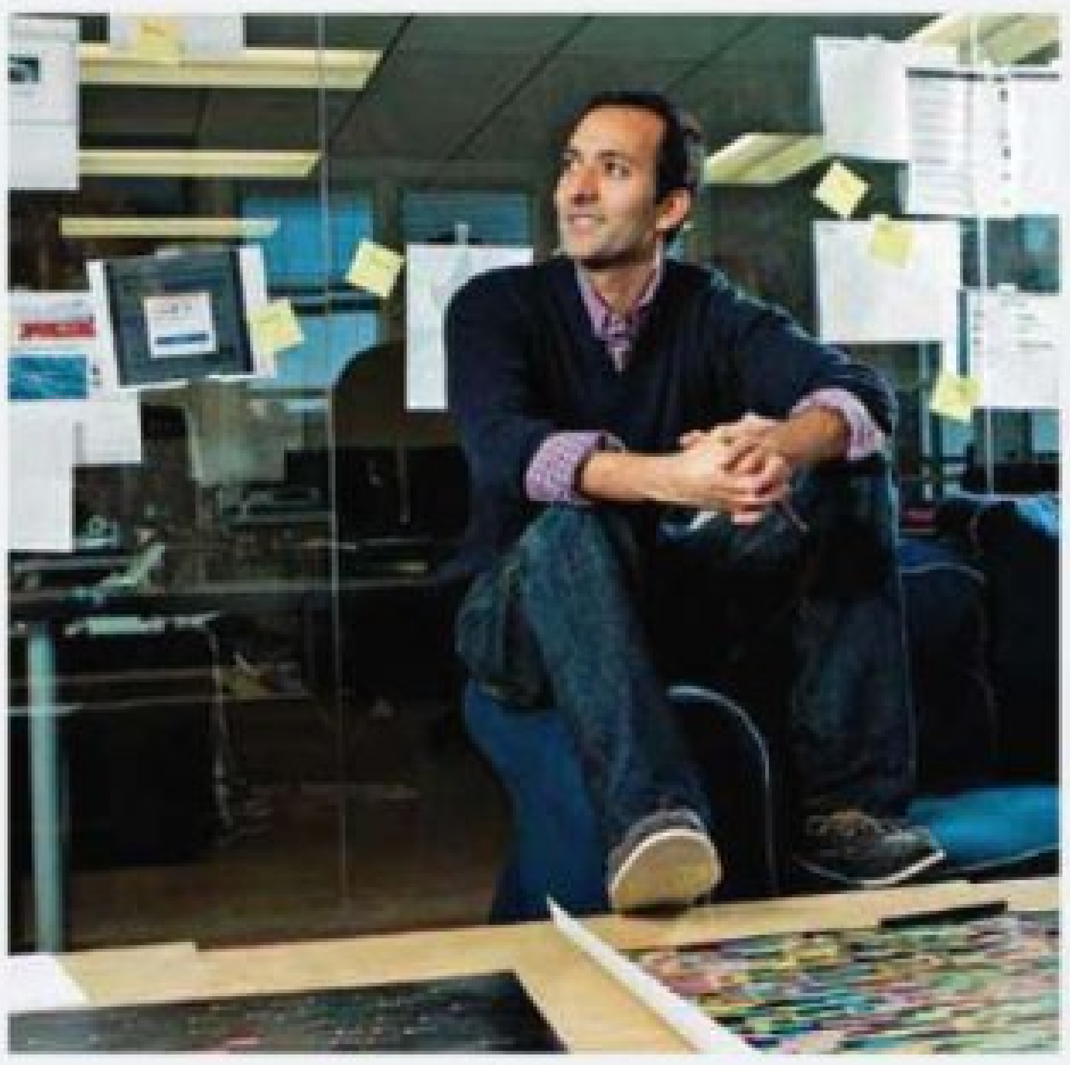
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Innovator

Amit Kapur



The former MySpace executive wants to build personalization software to help news sites and entertainment companies make better recommendations

Amit Kapur envisions a Web that's more about him. When he visits a news site, the headlines will be heavy on technology, his passion; when he opens Yelp on his iPhone, the restaurant review app will already know about his upcoming trip to San Francisco and recommend restaurants there. "I imagine this future where everywhere you go online or any application you open on your mobile device is in some way personalized to you and your interests," says Kapur, 29.

Gravity, the Santa Monica (Calif.)-based startup he co-founded last year after leaving the No. 2 post at MySpace, is the vehicle for bringing Kapur's imagined future into the here and now. The company first demonstrated its technology at the Web 2.0 Summit on Nov. 16, revealing how it creates detailed profiles of users based on the topics they frequently discuss on social sites like Twitter and the places they check into using location-based smartphone apps like Foursquare. The company's computers recognize over 100 million colloquial phrases and use them to discern users' interests; for example, someone who mentions a "free-throw shot" on Twitter is pegged as a basketball fan. Gravity's goal is to create a kind of digital fingerprint for each user. Other websites can then plug in Gravity's information and instantly personalize content and advertising for their visitors.

Many companies before Gravity have tried to perfect personalization; Pandora, Netflix, and Amazon have all been somewhat successful at it. But Kapur says these companies are mostly focused on improving their own services. There's an opening, he says, for Gravity to become an outside personalization engine that powers custom Web surfing on many different kinds of partner sites.

Kapur spotted the need for such a service while working at MySpace. He joined the social-networking site in 2005, shortly after graduating from Stanford with an engineering degree. He was one of the first dozen employees and rose to the rank of chief operating officer. As social networking sites proliferated and the amount of user-generated content grew, Kapur realized people were struggling to deal with information overload. He and two fellow MySpace executives left the News Corp. unit in March 2009 and started Gravity as a way to help extract signals from all the noise.

The 20-person startup hasn't announced a business model, but Kapur suggests it could make money by sharing ad revenue with sites that use its technology. Partnerships "will make or break this company," says Geoff Yang, founding partner of Redpoint Ventures, which participated in a $10 million investment in Gravity in May 2009. Kapur, who in 2008 helped broker the deals with music labels that paved the way for MySpace Music, says he's up to it. "We really believe that this is where the Web is going." —*Douglas MacMillan*

Education ▶ Earned an engineering degree at Stanford University

Backing ▶ Raised $10 million from venture capitalists in May 2009

Vision ▶ Apps and web sites that know who you are and what to recommend

Technology

haru Inaba (Seiuemon Inaba's son) takes questions once a quarter. In July, Inaba irked shareholders when he canceled the first-quarter briefing and filed a barebones earnings report that omitted sales breakdowns and data on orders. "Part of our strategy is to make sure we don't give our competitors information," Inaba, in a yellow blazer, explained at the October meeting.

Despite the standoffishness, Fanuc's shares have surged 40 percent this year on expectations of a growing appetite for factory automation in emerging markets (page 100). Net profit for the current fiscal year is on track to more than triple to $1.4 billion on sales of $5 billion, about double last year's revenue after a steep fall due to the financial crisis.

Some customers are starting to build their own control systems in an effort to wriggle out of Fanuc's grip, though few have the scale to pay for the necessary research. "It's not at all easy to do your controllers in-house," says Junichiro Shigemizu, a manager for **Okamoto Machine Tool Works**, which makes tools that sculpt parts for **Toyota Motors**, **Nissan**, and **Honda**. Though Okamoto this year started to replace Fanuc's controls with its own system in about 30 percent of its machines, Shigemizu says his customers have been wary.

For Fanuc, the bigger challenge comes from rival **Siemens.** The German controls maker is pushing hard in China. "This is a field we are definitely attacking," says Marc Wucherer, the head of Siemens' factory automation business in the mainland. And China's leading tool maker, **Shenyang Machine Tool**, in 2004 bought bankrupt German manufacturer Schiess to beef up its technology and is now developing its own controls. Shenyang declined to comment.

Inaba says he's ready for all comers, especially in emerging markets. Fanuc is pressing to get its tools into Chinese technical colleges to win over a new generation of machinists, and it has introduced a line of cheaper products for mainland factories. "We're working harder than ever to penetrate the Chinese and Indian markets," Inaba said at the October analyst meeting. "All of our capacity is running flat out." B —*Jason Clenfield*

The bottom line *With half of the global market for machine tool controllers, Japan's Fanuc can squeeze its clients for hefty profits*

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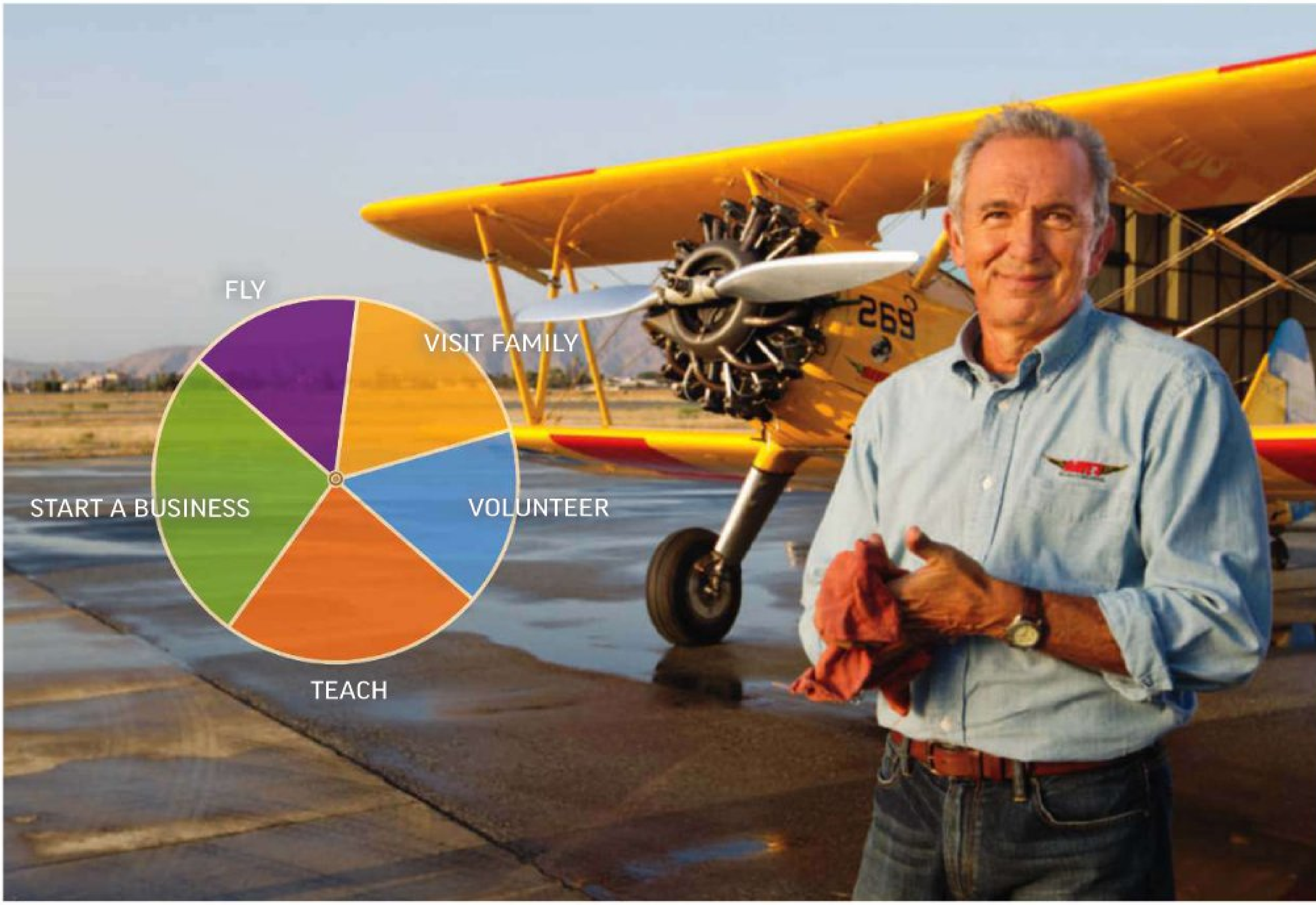


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The Exit Door Cracks Open For Private Equity

▶ **Buyout firms find they can sell shares to the public in some, not all, of their companies**

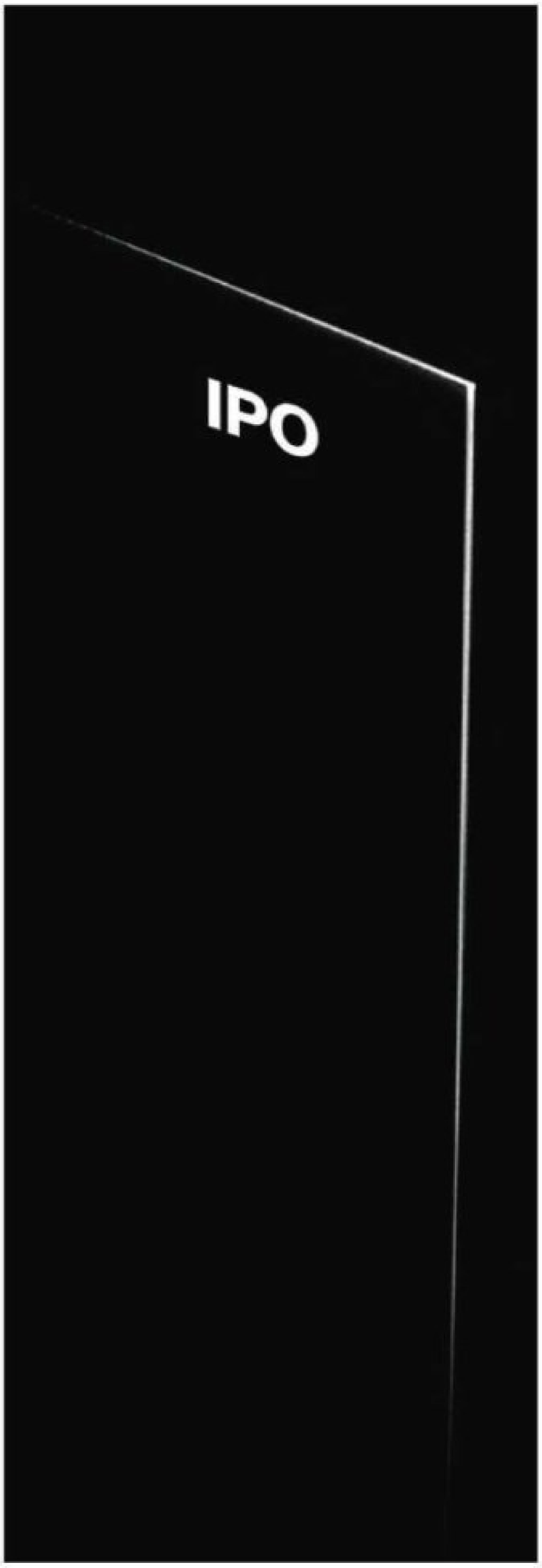
▶ **"A rising tide floats all boats unless there's a hole in the ship"**

With the stock market rallying 16 percent from the end of June through Nov. 19, private equity firms are finding it easier to take their holdings public—in some cases, that is. Since July 1, buyout firms have sold shares in a dozen of their companies, with 10 of them trading above their initial public offering price as of Nov. 19, including three that went public the week of Nov. 15.

Yet that same week, Harrah's, the world's biggest casino operator—now called **Caesars Entertainment**—became the first private-equity-backed company in six months to postpone its U.S. IPO after setting a price range, citing market conditions. "A rising tide floats all boats unless there's a hole in the ship," says Paul Schaye, managing partner of Chestnut Hill Partners, a New York-based firm that helps private equity houses identify targets. "When there's been something fundamentally done to [improve] the business, that's when you see the upside."

Private equity firms pool money from investors and obtain debt to finance takeovers with the intention of selling the companies later. The firms, which also earn money from advisory and financing fees, aim to profit by selling their companies to corporations or other investors, or by selling shares to the public. After the financial crisis, the capital markets were essentially closed to new offerings, with the number of IPOs in 2008 hitting a low not seen since at least 1982. That left private equity firms unable to reap profits by selling what they owned, hurting returns. Buyout funds as a class had an average loss of 0.9 percent for the three years ended in the first quarter of 2010, according to researcher Preqin.

Among the latest to go public: consulting firm **Booz Allen Hamilton**, backed by **Carlyle Group**; Boston-



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based brokerage **LPL Investment Holdings**, backed by **TPG Capital** and **Hellman & Friedman**; and semiconductor and testing equipment maker **Aeroflex Holding**, owned by **Golden Gate Capital**, **Veritas Capital Management**, and a fund run by **Goldman Sachs**. The 12 U.S. companies that buyout firms have taken public since July have gained 21 percent, on average, through Nov. 19. Only one, Carlyle Group's **CoreSite Realty**, was trading below its offering price. There have been 27 IPOs of private equity-backed companies this year, up from 22 in 2009 and 5 in 2008, according to data compiled by Bloomberg and Renaissance Capital.

Harrah's was scheduled to sell 31.3 million shares for $15 to $17. The company, which was taken private by **Apollo Global Management** and TPG in 2008, has cut its overall debt by about $5 billion through debt exchanges and other measures. Even so, it had more debt relative to cash flow than any private equity-backed company that sold shares this year except one, according to data compiled by Bloomberg. Harrah's had $18.39 billion more debt than cash at the end of September and generated $1.13 billion in earnings before interest, taxes, depreciation, and amortization (EBITDA) in the first nine months of 2010, according to its prospectus. That would give Harrah's a net debt-to-EBITDA ratio of 12.2 over a full year, more than triple the average of 3.93 for private equity-backed IPOs this year.

Harrah's has "a massive amount of debt," says Timothy Cunningham, a money manager at Santa Fe (N.M.)-based Thornburg Investment Management. "They really hadn't been private very long, there weren't a lot of material improvements, it just

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didn't look very attractive." A company spokesman declined to comment.

None of the private equity owners of LPL and Booz Allen sold shares in the recent IPOs. Some private equity firms have taken companies public in the past year and later sold shares in secondary offerings after the stock rose. **KKR** sold some of its **Dollar General** stake in a secondary offering in April 2010 after taking the company public in November 2009.

Companies that went public in the recent wave have been showing signs of strength. Booz Allen saw sales rise 8 percent from a year ago, to $2.71 billion in the six months ended Sept. 30. Net income more than doubled, to $43 million, according to a filing. TPG, the private equity firm run by David Bonderman and James Coulter, and Hellman & Friedman bought about 60 percent of LPL in 2005. The owners have overseen an expansion of the business, with the number of advisers growing at an annual rate of 15 percent. Aeroflex went private in August 2007. Its revenue rose 20 percent, to $155.9 million, in the quarter ended Sept. 30, and its net loss narrowed to $5.8 million from $20.5 million, according to filings.

Investors are not sure that the bigger companies owned by private equity firms can deliver robust growth, says Steven Kaplan, a professor at the University of Chicago Booth School of Business. Among the big companies waiting to sell shares are **Toys 'R' Us**, which filed for an IPO in May and has since sold loans to pay down existing debt, and **Nielsen Holdings**, owned by KKR, Carlyle, **Blackstone Group**, and **Thomas H. Lee Partners**. The television-audience rating company filed for an IPO in June.

HCA, the hospital chain acquired four years ago in a $33 billion leveraged buyout, filed in May for an IPO to raise as much as $4.6 billion. The company said this month it plans to pay a $2 billion dividend to its owners, a sign it will not be proceeding with its IPO in the near future. "What do IPO investors want to see? A growth story," Kaplan says. "If you're one of the big behemoths, it's hard to give them that. You need a strong economy." *—Jason Kelly and Michael Tsang*

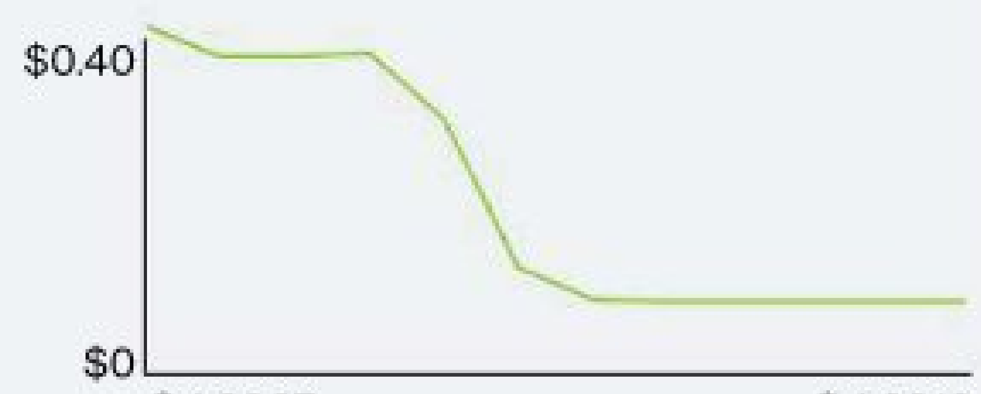
***The bottom line** Private equity firms are finding they can sells shares of companies with improving operations and without heavy debt loads.*

Financial Stocks

Bank Dividends May Be Set to Rebound

▶ JPMorgan Chase and Wells Fargo could follow Comerica's lead

▶ **Plunging Payouts**
Average dividend of six largest U.S. banks



DATA: BLOOMBERG

A regional bank's decision to double its dividend may be a signal that U.S. regulators will allow more of the nation's biggest lenders to lift their payouts. **Comerica**, the Dallas-based bank that posted annual profits throughout the financial crisis, boosted its quarterly dividend to 10¢ a share on Nov. 16. Banks including **JPMorgan Chase**, **Wells Fargo**, **U.S. Bancorp**, and **PNC Financial Services** may be next, says Jennifer Thompson, an analyst at New York-based Portales Partners. "You will see a number of the stronger banks increase their dividends in the first quarter," Thompson says.

The six largest U.S. banks by assets—**Bank of America**, JPMorgan Chase, **Citigroup**, Wells Fargo, **Goldman Sachs,** and **Morgan Stanley**—paid quarterly dividends totaling $2.49 a share in 2007. That's down to 51¢ a share, with Goldman's 35¢ payout representing the majority. Concern that bank capital was under pressure from souring loans prompted Federal Reserve officials in February 2009 to issue a letter saying financial firms "should reduce or eliminate dividends" when earnings decline or the economic outlook deteriorates. Barbara Hagenbaugh of the Fed and Andrew Gray, a spokesman for the Federal Deposit Insurance Corp., declined to comment.

Investors and analysts have used quarterly conference calls to press banking executives about dividend increases, and bank managers have chafed against limits set by regulators. Wells Fargo Chief Financial Officer Howard I. Atkins said last month that an increase is a "top priority" for the bank. JPMorgan Chase Chief Executive Officer Jamie Dimon said on Oct. 13 that he was "reasonably hopeful" the firm will be able to raise its payment in 2011's first quarter and that regulators were open to the idea.

On Nov. 17 the Fed issued guidelines on how it will decide whether large banks may increase dividends and buy back shares. Among the requirements is that banks must repay or replace any government investment with preferred or common stock. Banks must also show they can absorb losses if the economy sours. "The Fed has clearly made a decision that the industry, by and large, is able to or needs to issue dividends," says William Sweet, a former Fed attorney and a partner at Skadden, Arps, Slate, Meagher & Flom in Washington.

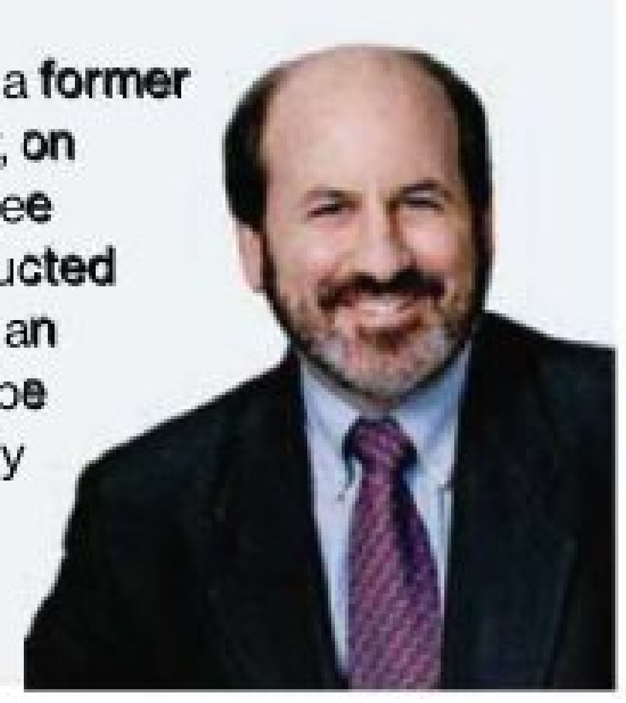
Richard X. Bove, an analyst at Rochdale Securities in Lutz, Fla., believes banks are making enough money to raise payouts. Earnings have topped estimates at 19 of the 24 banks in the KBW Bank Index that have reported since Oct. 7, according to data compiled by Bloomberg. This year the bank-stock index has gained 5.4 percent through Nov. 19, while the Standard & Poor's 500-stock index has gained 7.6 percent.

JPMorgan Chase and Wells Fargo are among the banks most likely to increase their dividends as early as the first quarter of 2011, Bove says. According to Bloomberg dividend forecasts, JPMorgan will quadruple its quarterly payout, to 20¢ a share, in February, while Wells Fargo's will double, to 10¢, in April. *—Dakin Campbell, Rita Nazareth, and Michael J. Moore*

***The bottom line** As the financial crisis eases and earnings improve, regulators may allow banks to start increasing their dividends.*

Quoted

"The government has decided it needs to use force to obtain all the information."
—Jacob Frenkel, a former federal prosecutor, on the FBI raids of three hedge funds conducted in connection with an insider trading probe by the U.S. Attorney in Manhattan



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Philip Falcone

Hedge Funds

Falcone Finds a New Way to Raise Money

▶ Harbinger's chief will use a shell company to pay for acquisitions

▶ "Our corporate structure provides significant advantages"

Philip Falcone, the hedge fund manager who made a fortune betting against subprime mortgages in 2007, has hit a tough patch. His flagship **Harbinger Capital Partners Fund** and another fund under his control have faced redemption calls from major investors anxious about the funds' investments in a wireless satellite network. Harbinger Capital is also at the center of an investigation by the Securities and Exchange Commission and the Manhattan U.S. Attorney's office over a $113 million loan it gave to **Harbinger Capital Partners** founder and Chief Executive Officer Falcone to cover a tax bill, according to two people with knowledge of the probe. Falcone, who declined an interview request, said in an e-mail that the loan "was documented and audited by outside accountants and legal advisers."

Despite his troubles, the hedge fund manager has found a way to raise funds in a difficult environment. Falcone, 48, is selling stock and bonds through **Harbinger Group**, a publicly traded shell company. On Nov. 15, Harbinger Group raised $350 million by selling five-year debt yielding 11 percent. Falcone plans to use the new capital to buy controlling stakes in industries from agriculture to telecommunications, according to a Nov. 1 filing by Harbinger with the SEC. To back the bonds, Harbinger hedge funds plan to give Harbinger Group most of their majority stake in **Spectrum Brands**, a publicly traded company whose products include Rayovac batteries and George Foreman grills, in exchange for additional Harbinger Group stock.

Most hedge funds raise money from institutional investors, such as pension funds, that can withdraw their money under certain circumstances. Owning a publicly traded company allows Falcone to pay for acquisitions by issuing stock. "Our corporate structure provides significant advantages compared to the traditional hedge fund structure for long-term holdings," Harbinger Group said in the Nov. 1 SEC filing.

Redemption calls are a worry now at Harbinger. **Goldman Sachs** plans to pull its entire $120 million investment from Harbinger Capital Partners following a 15 percent decline this year through mid-October and the disclosure about the personal loan to Falcone, according to people briefed on Goldman's plans.

Other investors such as **Advantage Advisers Management**, a subsidiary of **Oppenheimer Asset Management**, have also indicated they want out, according to regulatory filings. Falcone's New York-based firm's overall assets have declined to about $9 billion, as of September, from $26 billion in mid-2008.

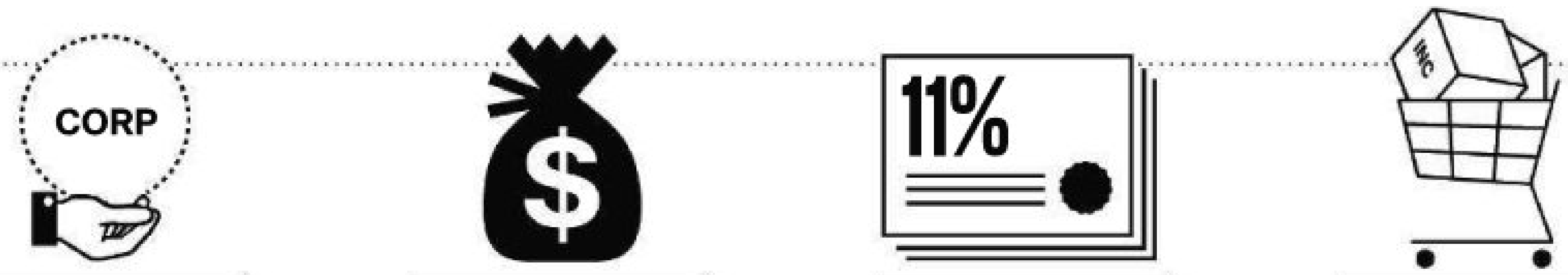
Falcone has angered some clients by investing about 90 percent of his flagship Harbinger Capital Partners Fund and more than half his **Special Situations Fund** in wireless-telecommunications investments, as of September. He is trying to build a multibillion-dollar satellite wireless network that would take on entrenched players such as **AT&T** and **Verizon Communications** through a company he created called **LightSquared**.

Falcone is liquidating about 80 percent of the $2 billion Special Situations Fund at the request of clients, investors say. He's been trying since June to raise $1 billion to $1.5 billion for LightSquared from investors who would be willing to commit capital for several years, according to potential investors who have seen marketing documents.

In theory, Falcone could use shares of Har- ➔ 54

Cash That Won't Flee

Coping with requests from investors who want to withdraw money from his hedge funds, Falcone has turned to the stock and bond markets for cash to fund future purchases. Here's how.



The Shell Company

Falcone's Harbinger Capital Partners paid $74 million for a 51.6 percent stake in Zapata, a onetime oil driller with no operations that is listed on the New York Stock Exchange. It reincorporated as Harbinger Group in December 2009.

The Funding

Harbinger's hedge funds plan to give Harbinger Group most of their stake in publicly traded Spectrum Brands, in exchange for additional stock in Harbinger Group. The funds will end up owning 93 percent of Harbinger Group, which will hold Spectrum Brands shares worth about $767 million.

The Bond Sale

In November, Harbinger Group sold $350 million of five-year bonds yielding 11 percent, backed by the Spectrum Brands shares it is getting from the Harbinger funds.

The Strategy

According to filings, Falcone will use Harbinger Group's cash and ability to issue stock to buy "controlling equity stakes" in companies that operate in six industries: consumer products, insurance and financial products, telecom, agriculture, power generation, and water and natural resources.

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Charlie Rose talks to

Steven Rattner



Quadrangle's co-founder and Obama's car czar just settled with the SEC over the pay-to-play pension fund scandal. Now, Andrew Cuomo wants a piece of him

When you were last here, you came to talk about your auto industry book, *Overhaul*. Let's start with what's happened since then.
Rattner: Since that conversation, I was able to reach a settlement with the SEC which, while tough, was acceptable to me in the spirit of getting on with my life. Andrew Cuomo, who is looking at exactly the same set of facts ... chose not to settle and to sue me for, in my view, a ridiculous recompense and other damages.

It is said to be for $26 million, plus a lifetime securities industry ban.
So it is said. We tried our hardest to reach an acceptable resolution. I have no interest in being in litigation with anybody, let alone the attorney general or the incoming governor of New York. But there are rights and wrongs in this situation, and I'm not going to agree to settle for something that is just not fair.

What are the facts that got you and Quadrangle Group, your former firm, in this mess in the first place?
We, along with a dozen or more other firms, made a decision to hire as a placement agent to raise money for us a man called Hank Morris, who I actually knew pretty well through politics, who I believed to be honest, who came to us highly recommended by people whose judgment I trusted, who, unlike many people who raise money for funds like ours, was registered ... with the SEC. He presented himself as someone who was building a business, raising money for funds like ours, which was a legal business then, and it's a legal business today.

So then what happened?
I awakened in February of this year to find that Mr. Morris and one of his colleagues ... had been indicted on something like 123 counts ... that they had done a number of things that were potentially illegal, none of which we were aware of but involving, potentially, kickbacks and fee-sharing and influence peddling. They were in a lot of hot water.

You settled with the SEC, negotiated with the attorney general but didn't settle. What's the difference here?
The difference is that Andrew Cuomo decided that for whatever set of reasons–the politics of this, the press, his own emotions, his people's emotions–that he would prefer to sue than settle. I don't really get it. I don't think it serves the people of New York well. I was perfectly prepared to reach a reasonable settlement as I did with the SEC. But I'm not going to be bullied by Andrew Cuomo.

Does this have to do with e-mails that later surfaced? [Cuomo had previously granted Rattner immunity, then took it away after seeing the new evidence.]
It would seem to me that the prosecutor should recognize that I'm not in charge of figuring out which e-mails to turn over. My instructions to our lawyers are very clear: Be fully cooperative.

Cuomo said on the radio that you took the Fifth Amendment 68 times.
That shouldn't be so surprising because over the past 15 months I have been subjected to every kind of threat of prosecution and punishment known to man, practically. My lawyers' advice to me ... was that I would be well advised to take the Fifth Amendment, and so I did.

People say to me, "This will be settled in the end. That's how it works."
I would settle it today. I would settle it tomorrow. I would settle it in six months on terms that make sense. If not, then we'll continue to litigate.

You've paid $6 million to the SEC.
I've already settled in monetary terms through the SEC, and that money probably comes back to New York State. I've already settled in exactly the same fashion every one of these dozen other firms have settled in. And so everything else is just frankly close to extortion.

What the attorney general has done is close to extortion?
I believe so.

Here's what your partners at Quadrangle, who settled, said: "Mr. Rattner's actions were inappropriate, wrong, and unethical."
That was one of the most hurtful things that's ever happened to me. I worked with these people for most of my career ... and I could not believe that they would throw me overboard to try to save the firm and themselves.

Now you have filed suit against them.
I [did that] because they have damaged my reputation substantially by comments like that. ... Plus they withheld very substantial sums of money that I'm owed. Look, I hate litigation. I don't think I've ever been involved in ... litigation before in my life, but I am going to see this one through. B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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The governor's "schnitzel strategy" page 65 ▶

binger Group, which is listed on the New York Stock Exchange, to meet redemptions in his hedge funds, says David Guin, head of the U.S. securities practice at law firm Withers Bergman in New York. Harbinger spokesman Jeffrey Zelkowitz says the proceeds of the bond sale won't be used to cover redemptions or finance investments in LightSquared. "Rather, HGI is a permanent capital vehicle to house longer-term controlling equity stakes in companies that operate across a diversified set of industries."

Falcone created Harbinger Group last year, when three of Harbinger's hedge funds paid $74 million to acquire a 51.6 percent stake in Zapata, an oil driller with cash and no operating businesses that was co-founded by President George H.W. Bush. Falcone reincorporated Zapata as Harbinger Group in December and later moved its headquarters to Manhattan from Rochester, N.Y. Having Harbinger Group gives Falcone a degree of freedom he doesn't have now, says Daniel Celeghin, a partner at Casey, Quirk & Associates, a Darien (Conn.)-based consultant to investment advisory firms: "Here is a pool of money you can manage indefinitely, and you don't have to worry about redemptions." —*Miles Weiss*

The bottom line *While dealing with investor redemptions, Falcone is raising capital through a public company he took over.*

Bankruptcies

A Stock Windfall for GM's Creditors

- ▶ Warrants for 273 million shares may add to a $5 billion haul
- ▶ "We value the shares of the new GM at $45," says an analyst

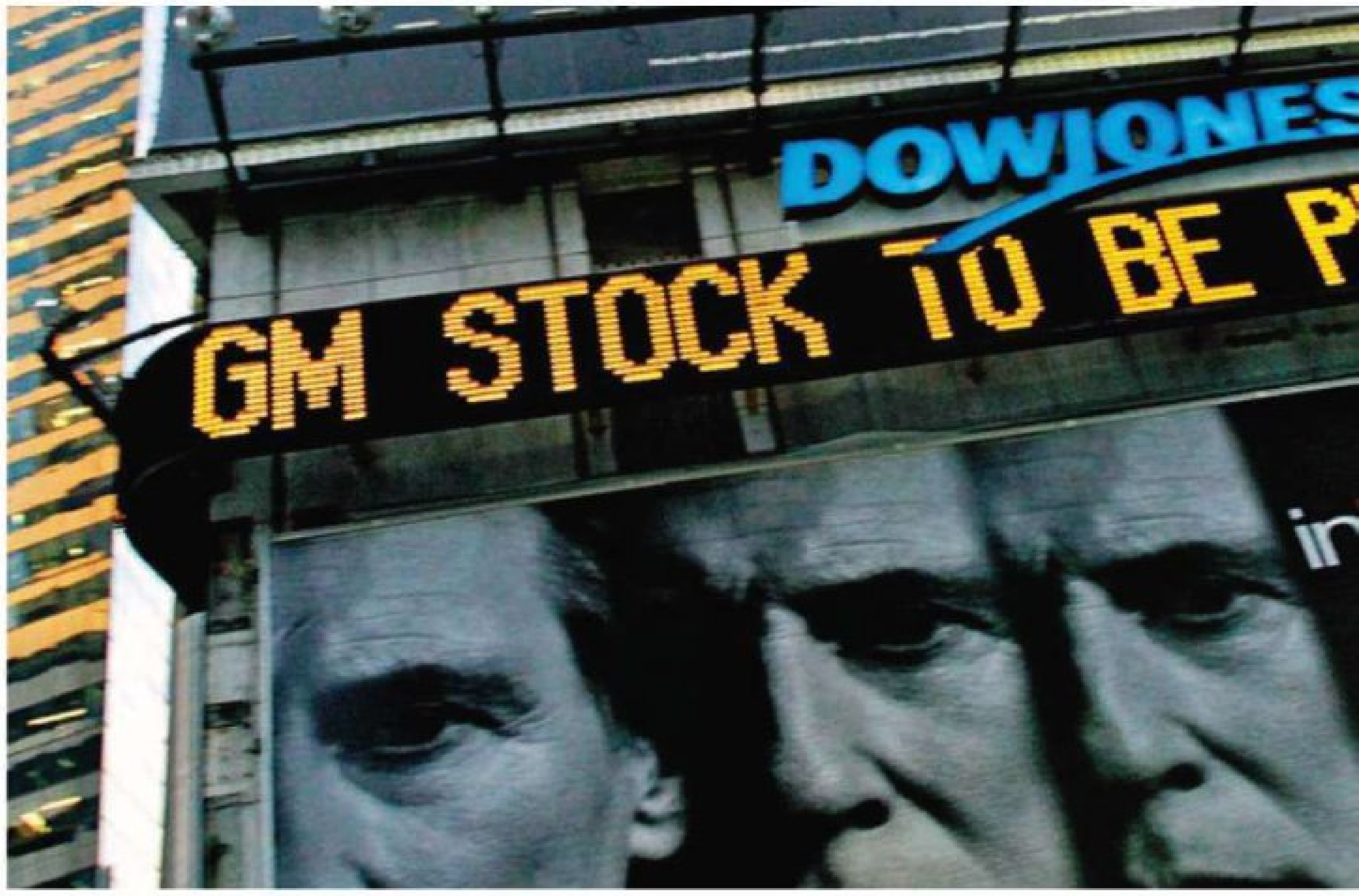
Creditors of **General Motors**' bankrupt predecessor, who will likely get about $5 billion from the new automaker's $20 billion initial public offering, might be able to buy millions more new shares at a deep discount.

GM's bankrupt estate got 150 million shares, or 10 percent of stock in the new company, to help pay off creditors. At the Nov. 19 closing price of $34.26, that stock is worth about $5.1 billion. So-called old GM has warrants that entitle it to buy about 273 million additional shares at $10 to $18 each, according to the company's Nov. 17 filing with the U.S. Securities and Exchange Commission. The warrants will become even more valuable if GM shares rise. At least one analyst expects they will. "We value the shares of the new GM at $45," says Kirk Ludtke, a senior vice-president at CRT Capital Group in Stamford, Conn.

The estate's creditors received rights to the shares after GM bondholders with about 54 percent of the carmaker's $27 billion in debt agreed to support a plan that swapped debt for equity. The bankrupt company, now known as Motors Liquidation, is still counting up creditors' claims, which totaled $35.7 billion as of Sept. 30, according to its last monthly operating report.

If unsecured claims end up exceeding $35 billion, the estate would get at least 10 million additional GM shares. If claims go as high as $42 billion, creditors could get as many as 30 million new shares, according to the IPO documents. "The stock is certainly worth more than almost anyone thought at the time," says Chip Bowles, a bankruptcy lawyer at Greenebaum, Doll & McDonald in Louisville.

When GM filed for bankruptcy in June 2009, it sold its most valuable assets, including its Cadillac and Chevrolet divisions, to a new company. Unwanted properties, such as outmoded factories and its Saturn division, were left under bankruptcy-court protection and are to be liquidated under a plan that repays loans from the U.S. Treasury and Canada.



While the IPO revenue is a potential boost for creditors, some holders of the old GM's bonds believe they should be getting more money now that the company has been revived. "The big issue that will be debated for a long time is whether the value being raised in the IPO is really value that should have been part of the estate for old creditors," says Michael P. Richman, chairman of **Patton Boggs**' restructuring practice, who represented bondholders challenging the government's plan for GM in June 2009.

The creditors won't get any stock until they agree on a liquidation plan and a judge approves it. One unresolved issue is General Motors' asbestos liability, which GM's estate estimates at $648 million. A committee of creditors said in court filings that the amount may be 5 to 10 times that much. Lack of consensus on a plan is "delaying distribution to literally thousands of innocent creditors," U.S. Bankruptcy Judge Robert E. Gerber said in a Nov. 22 hearing. —*Tiffany Kary and Linda Sandler*

The bottom line *GM's successful public offering is providing money to pay off creditors of the bankrupt company, who have warrants to buy more shares.*

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Creditors stand to make more money from GM's initial public offering

Currencies

On the Dollar, Traders Back Bernanke

▶ The markets show no sign that the Fed is undermining the greenback

▶ "The U.S. economy is starting to revive after summer weakness"

At a time when foreign officials and U.S. lawmakers are criticizing the Federal Reserve's plan to buy Treasury bonds, known as quantitative easing, the currency market is voting in favor of it. IntercontinentalExchange's Dollar Index, which measures the currency against those of six major trading partners, fell after Chairman Ben Bernanke signaled the Fed's move on Aug. 27. After the formal announcement of the plan on Nov. 3, though, it climbed 2.9 percent through Nov. 22. Futures traders have slashed bets for a decline in the dollar against the euro, yen, Australian dollar, and Swiss franc, data from the U.S. Commodity Futures Trading Assn. show.

Strategist forecasts for the dollar to weaken have all but disappeared. Since mid-October, the average of 38 estimates in a Bloomberg survey has been for the currency to trade at about $1.36 to the euro by mid-2011—just where it was on Nov. 22. "The dollar has found a bottom," says Lane Newman, director of foreign exchange in New York at ING Group.

Political figures from Chinese Premier Wen Jiabao to Representative John Boehner (R-Ohio), the nominee to be the next Speaker of the House, have criticized the Fed move to buy $600 billion of government debt. Boehner says the policy risks weakening the dollar and fueling asset bubbles.

Bernanke defended the quantitative easing in a speech on Nov. 19 in Frankfurt, saying that boosting U.S. growth is the best way to underpin the dollar and support the global recovery. Economists at London-based Barclays Capital said in a Nov. 19 report that U.S. growth will accelerate this quarter from 2.5 percent in the three months ended Sept. 30, while the 16-nation euro zone goes through "turmoil" as it fashions a bailout for Ireland.

UBS, the second-largest currency trader behind **Deutsche Bank**, raised its one-month forecast for the dollar to $1.30 per euro in a month from its previous estimate of $1.40, according to a Nov. 15 research note. "Europe's fiscal troubles are set to continue and the U.S. economy is starting to revive," wrote analysts led by Mansoor Mohi-uddin, the bank's chief currency strategist. "We expect investors to look more favorably on the dollar now." —*Catarina Saraiva*

The bottom line *While some politicians say quantitative easing will lead to declines for the dollar, the markets see stability for the U.S. currency.*

Mutual Funds

Why a Junk-Bond Investor Favors Stocks

▶ Fidelity's Notkin thinks the big high-yield bond rally has peaked

▶ "We love the auto sector," he says, citing its global growth potential

Fidelity Investments' Mark Notkin, whose high-yield mutual fund beat all rivals over the past five years, says the long runup in junk bonds is over and stocks are now a better buy. The manager of the $12.8 billion **Fidelity Capital & Income Fund** is putting more money into equities and into the secondary market for loans made by banks to risky corporate borrowers. And he's cutting back on high-yield junk bonds, which have soared 80 percent since the start of 2009. "I don't see the value in the high-yield market," Notkin says. "You are not being paid to take risk."

In April 2009, Notkin had 5 percent of his fund's assets in stocks, regulatory filings show. The figure was 17 percent in September of this year, according to Fidelity's website. "If I find opportunities, don't be surprised if it gets to 20 percent," says the manager.

Notkin took over Fidelity Capital & Income in July 2003. It's the third-largest U.S. junk-bond fund after the $17.3 billion **American High-Income Trust**, run by Los Angeles-based **Capital Group**, and the $13.1 billion **Vanguard High-Yield Corporate Fund**.

The fund fell 32 percent in 2008, compared with the 26 percent drop in **Bank of America Merrill Lynch**'s **U.S. High Yield Master II Index**, as the financial crisis prompted investors to dump risky assets. At the end of 2008, Notkin saw an "extraordinary opportunity" when junk-bond prices plunged as the credit crisis un- ➔

2.2

PERCENT

The decrease in existing home sales in October, as foreclosure moratoriums and a lack of credit disrupted the U.S. housing market

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folded, pushing the average yield above 20 percent. "At that point, I thought it made sense to be pressing down on the gas pretty hard," he says. Notkin used the fund's cash stake, which he had built to about 20 percent of the portfolio, to buy the riskiest high-yield bonds—those rated CCC and lower.



Notkin may shift 20 percent of the bond fund's assets into stocks

The bet paid off. Fidelity Capital & Income surged 72 percent in 2009, compared with a return of 58 percent for the Merrill Lynch index, according to Bloomberg data. In the five years ended Nov. 16, Capital & Income averaged gains of 9.9 percent, the best among 422 high-yield funds tracked by Morningstar. This year the fund has risen about 14 percent. "This fund is not for the faint of heart," says Miriam Sjoblom, a Morningstar analyst.

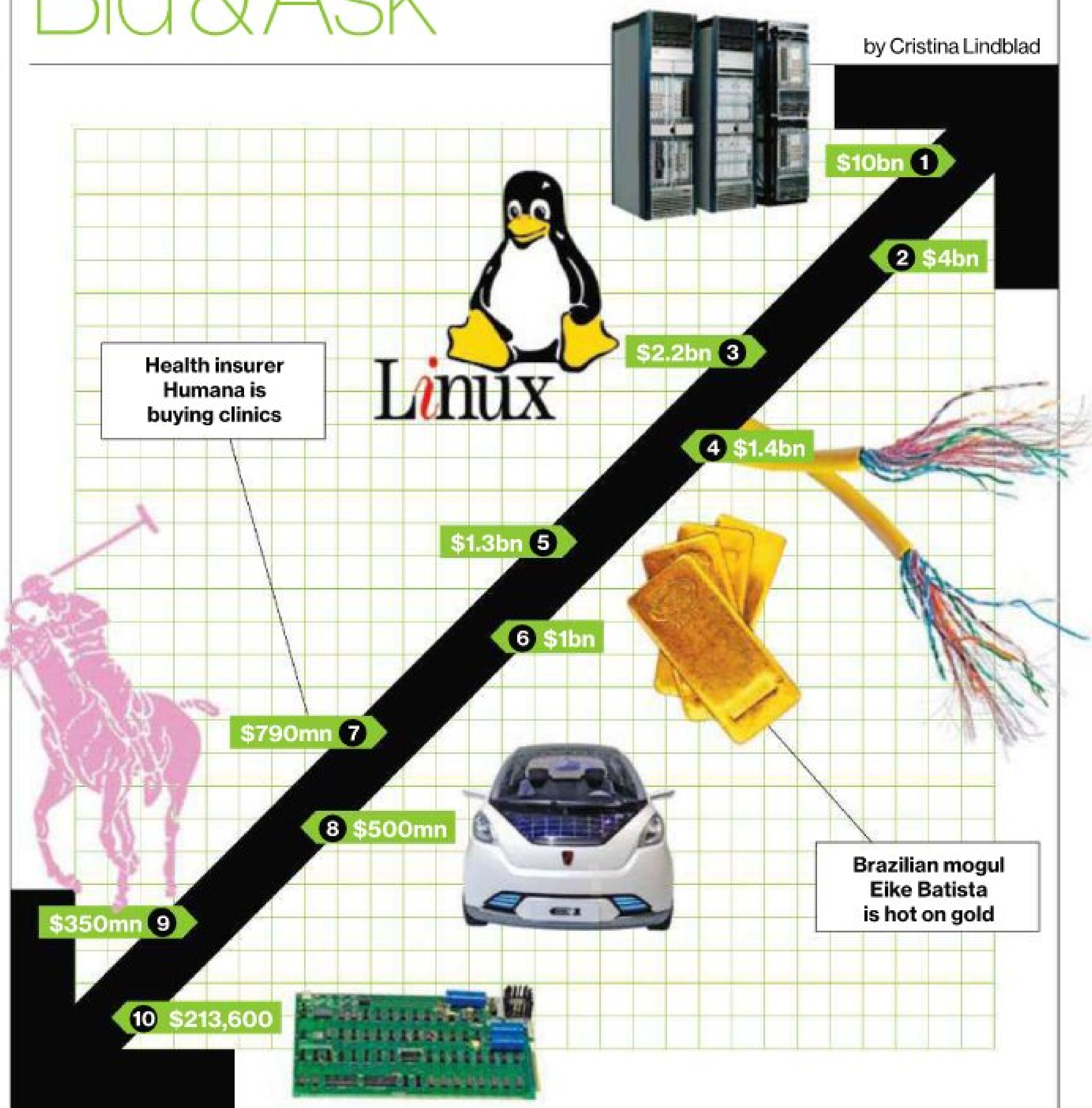
When buying stocks, Notkin favors industries such as technology and materials that will benefit from expanding economies in emerging countries. Shares of **Teck Resources**, which Notkin acquired in the third quarter of 2009, have climbed 72 percent since Sept. 30 of that year, Bloomberg data show. Vancouver-based Teck, Canada's largest diversified mining company, was the fund's 10th-biggest holding as of July 31. Vehicle-safety-equipment maker **TRW Automotive Holdings**, another top-10 position, has almost tripled in value over the same period. "We love the auto sector," says Notkin, because the business will continue to grow globally, and companies that sell safety and emissions gear will do especially well as governments around the world force carmakers to raise standards.

With prices on high-yield bonds near all-time peaks and yields at about 7.5 percent, near a record low, investors can expect gains over the next 12 months of about 7 percent, according to Notkin. "The market is fairly valued, if not overvalued," he says. "Compared to high yield, equity is very cheap."
—*Charles Stein*

The bottom line *After reaping big gains in junk bonds, Notkin sees more profit potential in stocks positioned to benefit from growth in emerging markets.*

Bid & Ask

by Cristina Lindblad



1. **Cisco Systems,** the world's No. 1 maker of networking equipment, added as much as $10 billion to its stock repurchase program, on top of the $72 billion already authorized by the board.

2. Rail-freight company **QR National** raised $4 billion in the largest initial public offering in Australia in 13 years.

3. **Novell**, the maker of Linux software that has reported sales declines for three of the last four years, agreed to be bought by Attachmate for $2.2 billion.

4. **Draka Holding**, an Amsterdam-based company that is the world's second-largest cable maker, is at the center of a bidding war that pits Dutch rival Prysmian, offering $1.1 billion, against China's Tianjin Xinmao S&T Investment, offering $1.4 billion.

5. Ohio-based **Cardinal Health** is paying $1.3 billion for Kinray, a closely held New York company that distributes name-brand and generic medicines.

6. Brazilian billionaire Eike Batista has offered slightly more than $1 billion for control of **Ventana Gold,** a Canadian miner with properties in Colombia.

7. Managed-health-care company **Humana** is buying Concentra, which operates workplace clinics and medical centers across much of the U.S., for $790 million.

8. General Motors sold a $500 million stake to Chinese partner **SAIC Motor**, cementing ties that have boosted GM's sales in the world's largest auto market.

9. A Japanese real estate investment fund is set to pay $350 million for the building that houses **Ralph Lauren's** store in Omotesando, one of Toyko's toniest neighborhoods.

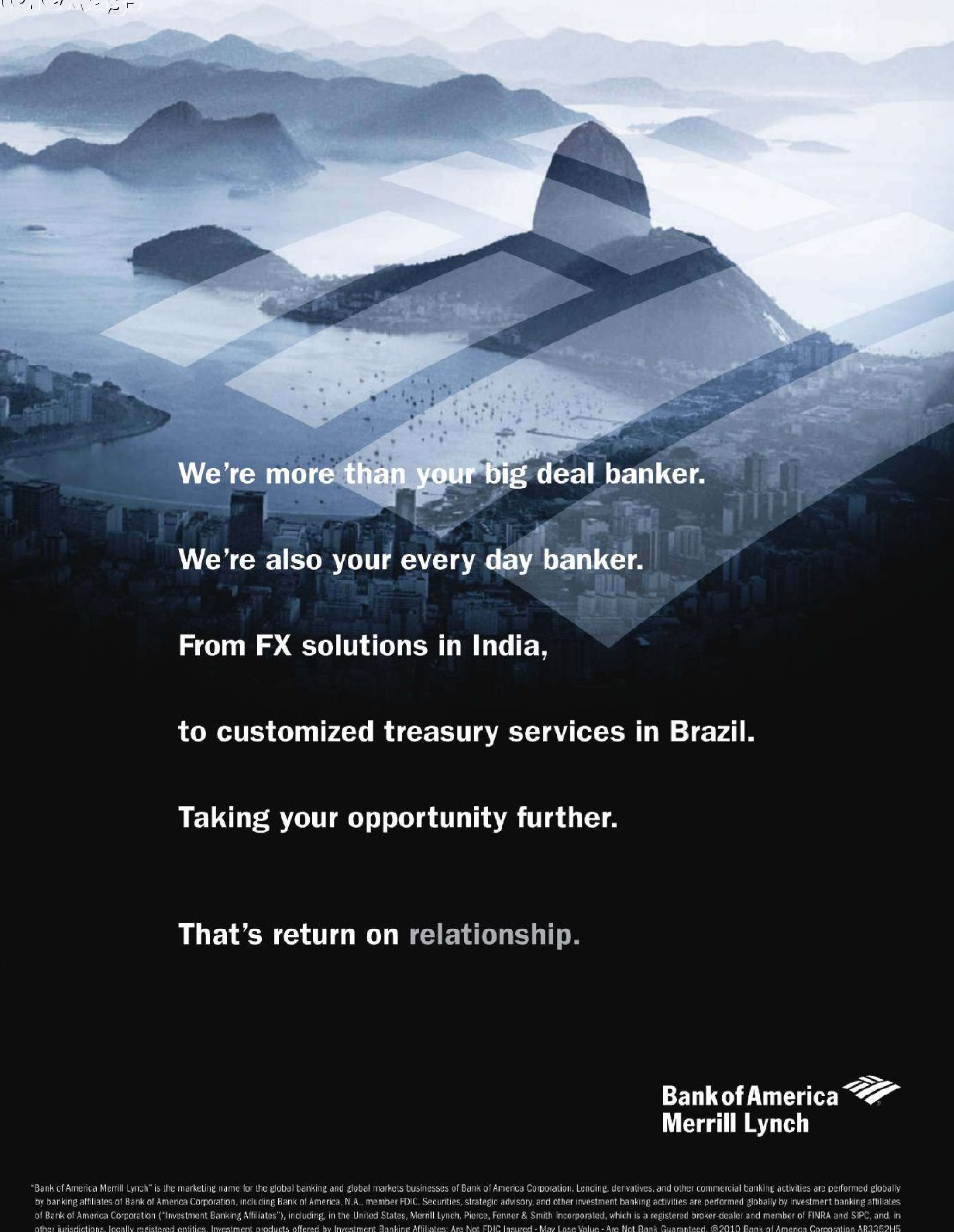
10. A vintage **Apple 1** computer fetched $213,600 at auction. The 1977 specimen, one of only 200 produced, came with its original packaging, including a signed "thank you" letter from Steve Jobs. Ⓑ

CLOCKWISE FROM TOP: CISCO SYSTEMS/BLOOMBERG; JONATHAN KANTOR/GETTY IMAGES; FRANTZESCO KANGARIS/BLOOMBERG; FRANKO LEE/AFP/GETTY IMAGES; TIM BOYLE/GETTY IMAGES

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Contents ▶ In West Texas, a mess over manure energy 60 ▶ Companies, governments, and NGOs unite to go green 61 ▶ It's no fun being a carbon trader these days 64 ▶ Speed Dial: Governor Schwarzenegger's "Wiener schnitzel" energy strategy 65 ● Edited by Cristina Lindblad

Focus On **Climate Change**



U.N. climate negotiations are bogged down. But a way can be found to unlock private financing for green projects

By Michael Liebreich

At the end of November the global climate change fraternity descends on Cancún for the latest attempt at replacing the Kyoto Protocol, which is set to expire in 2012. Last year's U.N. meeting in Copenhagen ended after two fractious weeks of protests and negotiations with a face-saving document long on promises but short on details. At Cancún the challenge will be to turn the Copenhagen Accord into a binding agreement.

If a deal could not be sealed last December, it will be even harder this year. Yvo de Boer, the head of the U.N. Framework Convention on Climate Change, who did more than anyone to create the sense of urgency around Copenhagen, has moved on. Gone are many of those who pushed hardest for an agreement last year, including Brazil President Luiz Inácio Lula da Silva and British Prime Minister Gordon Brown. Gone, too, is any remaining hope that the U.S. Congress might take decisive action.

The months since Copenhagen have seen a series of increasingly bad-tempered preparatory negotiating sessions. India has demanded that any outcome enshrine Kyoto, which gave developing countries a free pass on any binding commitments—a position supported by many of its emerging-market peers. The U.S. has refused to consider any framework based on Kyoto, which it feels will cost it jobs. China is investing heavily in clean energy but has refused to countenance any sort of verification of actions it is taking. Europe, which is grappling with fiscal crises, has been reduced to the role of bystander.



Not surprisingly, perhaps, de Boer's successor, Christiana Figueres, has spent her first six months on the job talking down expectations. She has been positioning Cancún as something of a reboot of the international process, an early step in a long engagement that might ultimately result in carbon emissions coming down.

Figueres hopes that after Cancún she will be able to point to progress on a number of concrete if modest initiatives, including a program that provides poorer countries with incentives to curb deforestation and another to speed up the transfer of low-carbon technology to the developing world. There may also be momentum on the deployment of $30 billion in funding, earmarked under the Copenhagen Accord for investment in the developing world to help it reduce emissions and deal with the effects of climate change. ➜

ILLUSTRATION BY TED MCGRATH; PHOTO: LATITUDESTOCK/GETTY IMAGES

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Yes, there are still Mad Men page 74 ►



This so-called Fast Start Funding was meant to be the first installment of a flow of investment by developing nations that would hit $100 billion a year by 2020. Immediately after Copenhagen the U.N. Secretary General convened a high-level advisory group to figure out how the $100 billion-a-year target could be achieved. Unfortunately the panel couldn't agree on key elements of its remit. Can the $100 billion include private funds, or must it be all public money? Can it include money invested in China?

This uncertainty didn't stop the committee's report from concluding that achieving the $100 billion-per-year goal would be "challenging but achievable" as long as the world adopted a carbon price of at least $20 per metric ton along with taxes on global aviation and shipping—a position that seemed quixotic before the U.S. midterm elections and almost delusional after. To its credit, though, the panel did not back a Tobin tax on financial transactions.

The irony is that just as the U.N. negotiations are bogging down, the commitment of the world powers to act on climate change is becoming clear. Global investment in clean energy—renewables, energy efficiency, and other technologies to reduce emissions—has soared from $46 billion in 2004 to nearly $200 billion this year, shrugging off the recession to reach a new record. This is mainly private money, responding to a flood of regulation and government incentives in support of low-carbon energy or energy efficiency.

More than 90 percent of this investment has taken place in the developed world or in rapidly emerging economies such as China and Brazil. The countries that are finding it hard to secure climate finance are those that have underdeveloped capital markets and poor records on attracting foreign direct investment. And therein lies the germ of a solution to the $100 billion challenge.

Instead of dreaming of a global carbon market or a global tax on financial transactions or trade, ask yourself this: Under what terms would you want your pension or tax dollars being invested in infrastructure development in the world's poorest countries? The answer: when it's not going to disappear.

Here is how it might work: Take the $21 billion already being invested annually in clean energy by multilateral and national development banks. Increase it by as much as fiscal constraints will allow. Throw in a sovereign guarantee, underwritten by the same governments that signed the Copenhagen Accord and reaffirmed their commitment to fighting climate change at this month's G-20 meeting in Seoul. Mix in some currency hedging to protect investors from macroeconomic forces beyond their control. Add a sprinkling of grants to cover the extra cost of clean energy over fossil-based (a differential that is shrinking all the time). Throw in a few export credits and some funding via the existing carbon markets, stir the mixture, and secure an investment-grade rating. This is the only way to get the big pension funds interested and generate funds on the scale required.

For Western taxpayers to underwrite a sovereign guarantee on anything like this scale, the acceptance of these cheap climate funds would need to be conditional on an investment treaty. Recipient countries must not be allowed to expropriate the resulting projects. They also would have to commit to phasing out subsidies to fossil fuels.

Will all developing countries agree to this formula? Almost certainly not. But who says they need to? To those that do agree go the funds. To those that don't—wait and see if there's a better deal on offer in the U.N. process. If not, then this sort of Coalition of the Committed may be the best way for the world to move from rhetoric to action.

Michael Liebreich is CEO of Bloomberg New Energy Finance.

Quoted

"There is a deal to be done. Cancún will be a success if parties compromise. I am not going to underestimate the political gaps that need to be bridged."
—Christiana Figueres, the U.N. diplomat leading climate negotiations, at a Nov. 15 press conference in Bonn



Cleantech

A Stinking Mess in Central Texas

► **Trying to save the nation's biggest poop-to-natural-gas plant**

► **"It was going to be win-win for everyone"**

Erath County, Tex., produces two commodities in bulk: milk and manure. Visitors to the Victorian-era courthouse in Stephenville, the county seat, 70 miles southwest of Fort Worth, are greeted by an imposing fiberglass cow named Moola. The tons of waste produced by bovine herds, however, have created, well, a stink in the area. For years, officials in downstream Waco accused the dairies of contaminating the water supply. So when a New York-based renewable energy company proposed taking the muck off farmers' hands at no charge, everyone loved the idea. The plan was to transform the manure into a climate-friendly gas for energy. "It was going to be win-win for everyone," says July Danley, head of the Stephenville Chamber of Commerce.

Poop-to-gas plants—the technical term is anaerobic digesters—are not new. They're big in China and northern Europe, thanks to government subsidies. In the U.S. the technology enjoys support from green groups. "I'm very high on that approach," says James D. Marston, director of the Environmental Defense Fund's energy program. Yet federal grants and loans to the industry totaled just $37.2 million through 2009. While the number of projects has increased from a dozen in 1990 to more than 150 today, according to federal statistics, they're generally more modest in scale than many abroad.

The exception is Texas, where everything is bigger. Here, on the outskirts of Stephenville, North America's largest digester facility sprawls across 73 acres. The surrounding air smells as pungent as one would expect. Shaped like fat grain silos, the eight five-story anaerobic digesters that form the core of the 22-employee plant were humming on a recent autumn morning. Manure mixed with water was flowing into the computer-controlled 916,000-

ALEXANDER F. YUAN/AP PHOTO; OPPOSITE PAGE, FROM TOP: AMY CONN-GUTIERREZ/AP PHOTO; ILLUSTRATION BY CHRIS SILAS NEAL

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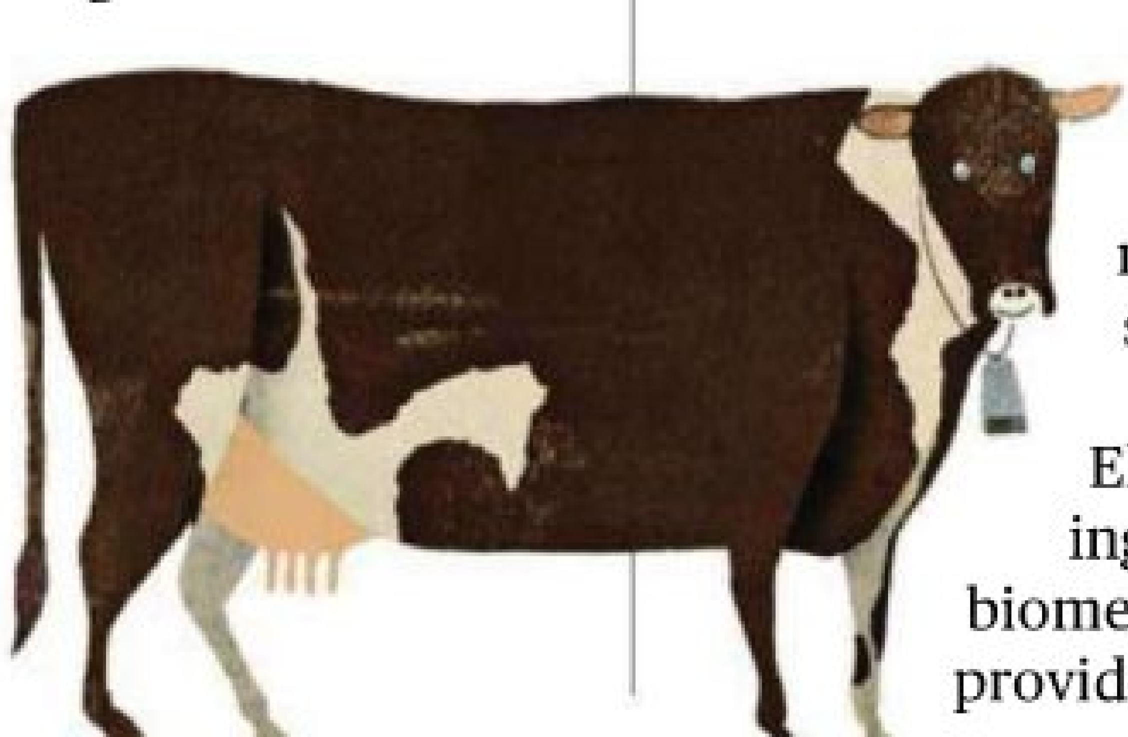
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Digester tanks turn manure into biogas

gallon digesters. There the sludgy organic material decomposes into biogas—methane, mostly—which is refined into pipeline-quality natural gas. The developer, **Microgy**, signed contracts to supply utilities in Texas and California, claiming the plant could meet the energy needs of 10,000 homes. The U.S. Environmental Protection Agency promoted the project on its website, and Microgy boasted as recently as May that it did not need government backing to succeed. "We're sustainable without incentives," Executive Vice-President Michael Hvisdos told the website ClimateWire.

In July, Microgy's parent, Tarrytown (N.Y.)-based **Environmental Power**, filed for bankruptcy, saying it would liquidate. The company was partly a victim of its own ambitions: It expanded too quickly, with projects in California, Colorado, and Wisconsin, and borrowed too much. Environmental Power's revenues jumped 62 percent in 2009, to $4.7 million, yet its losses more than doubled over the same period, to $36 million. A Securities and Exchange Commission filing from April shows long-term liabilities totaling $50 million. It wasn't just an excess of debt that sank the enterprise, though. The death of national climate legislation exacerbated Environmental Power's difficulties and hampered the renewable energy market more broadly. If Congress had created a system to reduce carbon emissions by setting caps and encouraging companies to trade pollution permits, projects such as the one in Erath County could have benefited by selling credits linked to the clean energy they produce. The surging supply and falling price of natural gas didn't help either, denting the competitiveness of more expensive renewable energy. The company's former chief executive officer, Richard E. Kessel, declined to comment.



Still, there may be hope for the Stephenville project. In November, a buyer scooped up the plant at the bargain-basement price of $3.3 million. Riding to the rescue—and signaling at least some long-term confidence in manure-to-energy—is **Element Markets**, a carbon-trading firm in Houston co-founded by Lou L. Pai. Pai has had a long and, at times, controversial career in energy. After working at **ConocoPhillips** and **DuPont**, he landed at Enron in the 1990s, where he led the retail energy unit. Pai left Enron six months before it collapsed in late 2001, pocketing more than $265 million from exercising Enron options and selling stock, according to a U.S. Senate panel. Without admitting wrongdoing he agreed to forfeit $25 million to settle SEC allegations that he abused inside information to dodge investment losses before Enron's demise. He was not charged. Pai did not return a phone message seeking comment.

Randall N. Lack, Element's chief marketing officer, says: "The biomethane market can provide clean energy and reduced emissions while being commercially successful."

Element might have better luck revving up the Texas plant, because the bankruptcy process has stripped the facility of its daunting debt burden. The company says on its website that it works with utilities, municipalities, and companies to develop renewable energy, trade environmental credits, and nurture new clean energy ideas. One of the images on the site is that of a handsome brown cow mooing under a wide-open sky. —*Paul M. Barrett*

The bottom line *Too much debt nearly sank a huge project to turn cow manure into gas. Can new owners keep it afloat?*

Corporate Responsibility

Unlikely Allies in the War Against Carbon

▶ Companies are teaming up with NGOs and governments to go green

▶ "The issues are so systemic that no one company can do it alone"

Although aggressive climate action is basically frozen in the U.S., the hard work of emissions reduction continues among states, cities, corporations, and nonprofits. On Nov. 16, California Governor Arnold Schwarzenegger launched R20, a public-private partnership of regional players that seeks measurable reductions within five years (page 65). Environmental groups, while girding for courtroom battles against corporations seeking

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63%

of energy professionals believe the greatest opportunities for improving efficiency in the energy value chain can be found among industrial end users.

Energy

The drive to reduce energy consumption worldwide has begun to focus on the industrial sector.

That's because industry uses more energy globally than any other end-use sector, currently consuming about 50 percent of the world's total delivered energy. The awareness that industrial consumption is growing inexorably as global living standards rise is contributing to a transformation of the entire energy system. And though there are challenges—including the need to limit CO_2 emissions while meeting rising demand for power and ensuring grid reliability at the same time—industry experts believe there is still a significant potential for reducing energy use by industrial, commercial and even household consumers. These include smart grid technologies that facilitate the use of renewable energy and help increase efficiency. In fact, more than half of the energy sector stakeholders queried in a recent survey indicate that the best option to manage growth in industrial energy demand may be through increasing industrial energy efficiency.

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to roll back coming carbon regulations from the Environmental Protection Agency, are also working with companies that want to make their businesses more sustainable.

The first significant alliance between a corporate giant and an environmental nonprofit came in 1990, when **McDonald's** began working with activists at the Environmental Defense Fund to get rid of the chain's ubiquitous foam clamshell containers. Another milestone came in 2005, when retail giant **Wal-Mart Stores**, working with Conservation International, EDF, and other groups, set ambitious targets to create zero waste, rely solely on renewable energy, and sell only products deemed "sustainable" by 2015. Now such partnerships are a key to the reduction of carbon emissions. In September, **Duke Energy**, **Cisco Systems**, and local leaders in Charlotte, N.C., announced a push to reduce energy use in the city's core commercial buildings by up to 20 percent by 2016.

"The tide has turned," says Gwen Ruta, EDF's vice-president for corporate partnerships. Despite setbacks in Washington, she says, "There's this sense of inevitability that they have to adjust to a world where resources are scarcer and there's a price for carbon."

Successful green partnerships are rarely monogamous. While McDonald's maintains ties with EDF, the bulk of the company's sustainability efforts are channeled through broader industry initiatives that bring suppliers and even rivals into the mix. "The issues are so systemic that no one company can do it alone," says Bob Langert, McDonald's vice-president of corporate social responsibility.

Wal-Mart, long a target for green activists, announced a goal earlier this year of eliminating 20 million metric tons of greenhouse gas emissions from its global supply chain by the end of 2015. The behemoth is working with nongovernmental organizations at every level. "As big as we are, we can't take on these issues on our own," says Miranda Ballentine, Wal-Mart's director of sustainability.

For watchdog groups, the aim is measurable results. "We're supposed to be the voice for our mission, not the voice for shareholders of a corporation," says Jonathan Lash, president of the World Resources Institute. "It's our job to keep the pressure on." WRI and the World Business Council for Sustainable Development have created the Greenhouse Gas Protocol, a widely used accounting tool to track emissions.

EDF remains one of the most active players, with a "Climate Corps" staffed this year with 51 business school interns. Working with 47 companies, this summer's interns identified energy savings equal to taking some 67,000 SUVs off the road. At **Eaton**, Vice-President Dimitri Kazarinoff says collaboration with EDF and **FedEx** to develop hybrid trucks helped generate technology that is now in use in hybrid buses in Beijing. EDF teamed up with **Donlen**, a Chicago company that leases and manages corporate fleets, in a push to cut emissions from the commercial fleet by 20 percent. "We could not have made this a global industrywide effort without EDF," says Dan Hannan, Donlen's senior vice-president of sustainability. "The inaction of the government has created a strong corporate sense of responsibility to do something ourselves." —*Diane Brady*

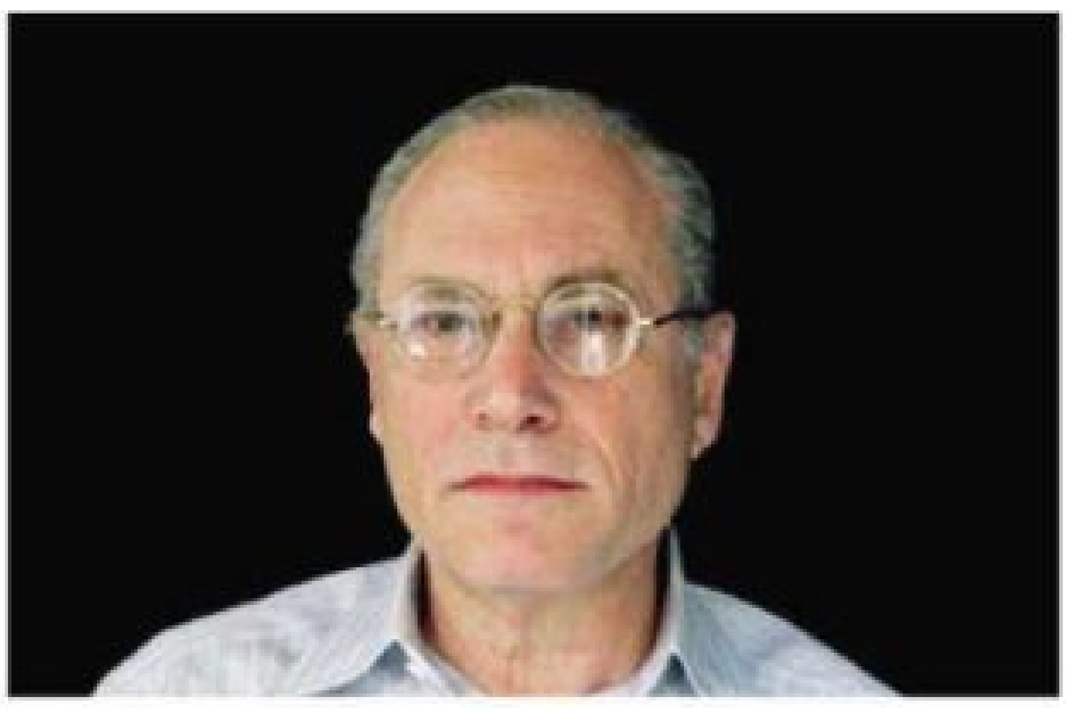
The bottom line *Companies from FedEx to Wal-Mart have enlisted the help of environmental groups to cut their greenhouse gas emissions.*



Eaton's work with EDF paved the way for these hybrid buses in Beijing

Markets

Carbon Traders Need Not Apply



▶ Wall Street's hopes of cashing in on cap and trade are up in smoke

▶ "Carbon traders are calling me to ask what they should do"

Just three years ago, George H. Stein, a managing director at New York-based recruiter **Commodity Talent**, was seeing a brisk volume in calls from Wall Streeters looking to make a career switch. While oil traders were getting pilloried on Capitol Hill, a new line of work promised to deliver wealth and social benefits: buying and selling carbon permits in the emerging market designed to control global warming pollution. "There was such a great deal of interest in carbon trading," recalls Stein.

U.S. states were uniting to go on low-carbon diets. Companies were stepping up their own with targets. The Congressional Budget Office estimated that under a cap-and-trade plan, the U.S. market for the permits, which companies would need in order to emit CO_2, could be worth as much as $300 billion by 2020. Today, with prospects for a federal cap-and-trade program dead and prices in voluntary carbon markets in the U.S. collapsing, "Carbon traders are calling to ask me what they should do now," says Stein.

Energy trading consultant Peter Fusaro says he recently counseled a college grad looking to get into emissions trading to find a job on an oil and gas desk and bide his time until carbon comes back. "Carbon trading in the U.S.," says Fusaro–"there's no there there."

The European Union's carbon market, which has been operating since 2005, continues to grow. Trading volumes were up 8 percent in the

FROM TOP: JUSTIN STEELE; DOUG KANTER/BLOOMBERG; OPPOSITE PAGE: PETER MACDIARMID/GETTY IMAGES

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third quarter compared with the same period last year. In the U.S., what activity there was is withering. The Chicago Climate Exchange (CCS), once billed as a Nasdaq for CO_2, saw carbon prices drop to a nickel per ton before announcing on Nov. 17 that it would cease operations at the end of the year. CCS was founded in 2003 by Richard L. Sandor (pictured), an economist who's been called the father of financial futures. Some 450 companies, including **DuPont**, **Honeywell**, and several utilities, signed legally binding contracts to reduce their emissions. Those who succeeded in cutting CO_2 could sell their credits to others that were having a harder time complying with CCS emission targets.

Bloomberg New Energy Finance reported on Oct. 1 on the "collapse" of trading in another U.S. market, the Regional Greenhouse Gas Initiative (RGGI), a consortium of ten Northeastern states that joined together to cap and trade greenhouse gas emissions from power plants. The RGGI's stated goal: cutting utility emissions by 10 percent by 2018.

Carbon jobs are dying, too: Last year **JPMorgan Chase** acquired carbon brokerage EcoSecurities for $206 million. It has since cut staff and pulled out of projects. "There's not enough clarity to continue to be able to invest in the market robustly," EcoSecurities Chief Executive Officer Paul M. Kelly said at a conference in May.

It's not all gloom and doom, says Sandor: "The message continues to be that in the absence of federal legislation, a bottom-up approach ... seems to be key." California, the world's eighth-largest economy, is moving ahead with its own cap-and-trade program. The state's Global Warming Solutions Act envisions a reduction in greenhouse gases to 1990 levels by 2020. On Nov. 17, **Barclays Capital** announced it completed what it said is the first trade of carbon allowances under California's program, in conjunction with power generator **NRG Energy**. Says Jason Patrick, the vice-president in charge of **Bank of America Merrill Lynch**'s Carbon Markets group: "You've got to be adaptable and find business where it exists."

—Roben Farzad

The bottom line *The failure of U.S. climate legislation has derailed efforts to build a robust carbon trading market stateside. All eyes are now on California.*

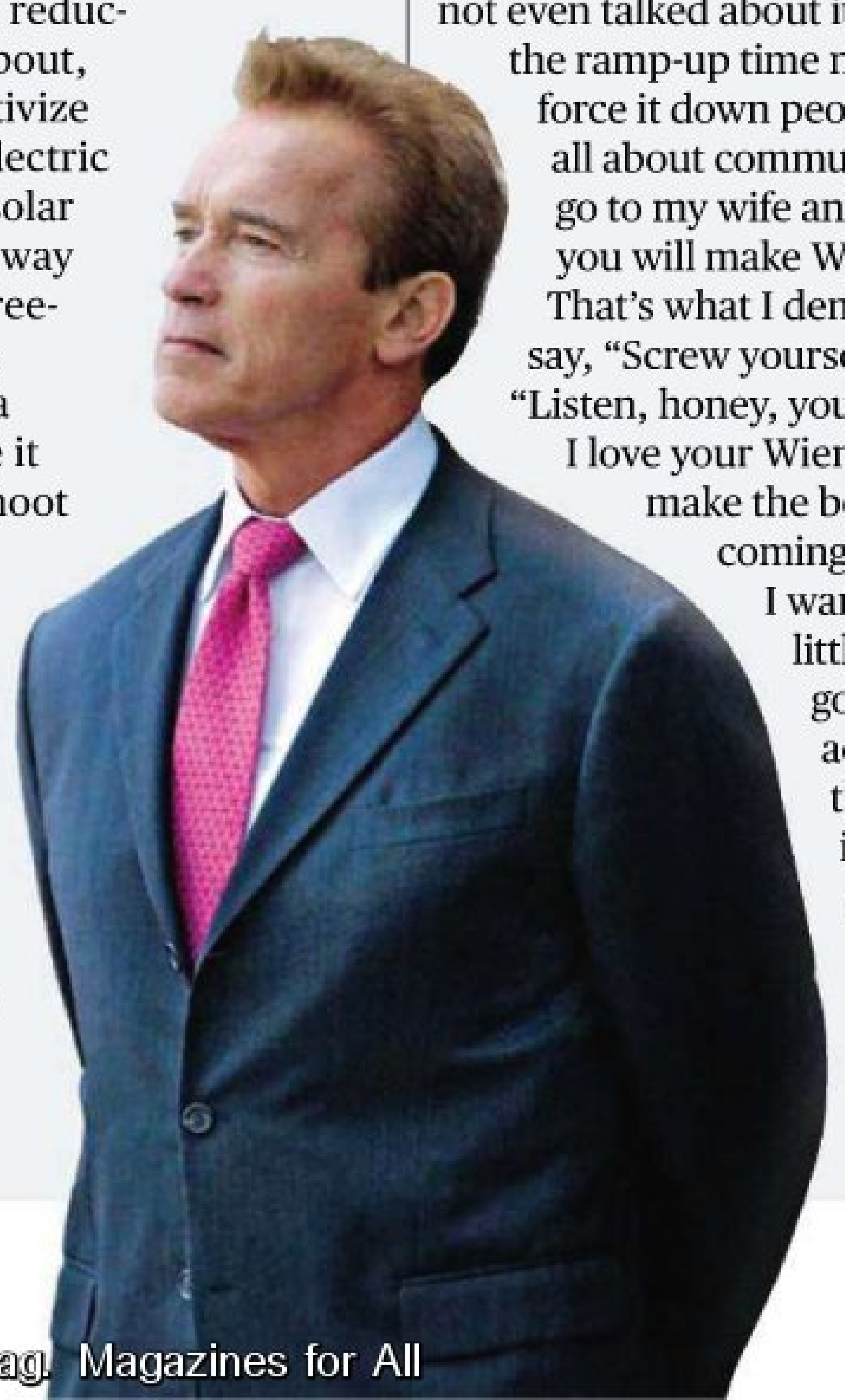
Speed Dial

Governor Arnold Schwarzenegger

Savoring a win over a ballot initiative that would have overturned his climate bill, the lame-duck Governator explains his "schnitzel strategy"

California voters resoundingly defeated Proposition 23, which would have killed your state's cap-and-trade program. Were you surprised by the victory margin?
No. First we only wanted a victory, but then we saw that our broad alliance just kept growing–everyone came out against the oil companies [Valero and Tesoro, which sponsored Prop 23]. We even had other oil companies, like Chevron, working with us.

You bucked a national trend away from cap and trade.
Let's forget about that dialogue for a while. Not always, "What is your commitment to carbon reductions?" Let's talk about, "How do we incentivize America to build electric cars, hybrid cars, solar everywhere?" The way you come to an agreement is if you back off and say, "Take a deep breath, shake it out. What do we shoot for here? Maybe there's another way to reach our goal."



You're moving ahead with the cap in California. If it succeeds, could that change the national debate?
It's already working in Europe, but people don't pay attention. We'll succeed, and the Northeastern states are doing it [in the power sector], and the Western states, too.

Your new coalition, R20, hopes to scale regional action globally.
We can't afford to wait for national and international agreements. Just because America doesn't have a national agreement doesn't mean zero is going on here. There's a lot going on. At the Long Beach and L.A. ports we're turning diesel trucks into electric trucks. Hybrid tugboats. And the ports are making more money than ever, even though they screamed in the beginning.

Why have Californians made the connection between clean energy and job creation in a way people elsewhere in the country have not?
We have been working on this and talking about it for many more decades. We started early on; other states have not even talked about it, so they need the ramp-up time now. We can't force it down people's throats. It's all about communication. I can go to my wife and say, "Today you will make Wiener schnitzel. That's what I demand!" She may say, "Screw yourself!" But if I say, "Listen, honey, you know how much I love your Wiener schnitzel. You make the best. I have friends coming from Austria, I want to show off a little bit." Now she's gonna jump into action, pounding the meat, because it was a different spin. It's all about the same results by other means. The schnitzel strategy! ⓑ

—Eric Pooley

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The Wire



From AT&T surveillance cameras, footage of copper thefts in progress

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With copper prices near record highs, thieves are tearing the country apart.
By Ben Paynter



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For almost a year, Mid City Recycling operated out of a cavernous warehouse next to a liquor store on South Industrial Boulevard in the seedy south side of Dallas. The startup seemed to have popped up out of nowhere. Out front there was a sidewalk sign with a Mexican flag letting everyone know that the proprietors spoke Spanish. Beside it, a small truck draped with a banner read, "$We Pay Big Bucks$." There was no need to say for what.

For five weeks during the summer of 2009, undercover agents with the Dallas Police Metal Theft Unit watched Mid City. One at a time, they pulled into the rutted parking lot in unmarked sedans or SUVs. With tiny spy cameras attached to their shirts, they lugged in buckets of insulated electrical wiring and suspiciously stripped transmission lines, threading past dunes of scrap metal piled high enough to block out the ceiling lights far overhead. The metal was weighed on a small scale and the transaction finished at a glassed-in cashier's window.

Afterward the footage was reviewed by Lieutenant Richard Dwyer, then the unit commander. "This is a great picture of the roof," he said when one of the men returned with useless footage from a poorly angled camera. They kept filming. Dwyer wanted proof that Mid City was functioning as a black market. If they could find that proof, they would be slightly closer to bringing a crime spree under control.

Dallas, like many cities, was being rocked by copper theft. That might not sound as threatening as bank heists or murder sprees, yet the scope and frequency of the crime threatened to disrupt a far more important target—the wiring and plumbing that makes up the central nervous system of the city itself. And Dallas was, and is, not alone. Thanks to a boom in the copper market, city services around the country are being hit, leaving law enforcement agencies nationwide scrambling to understand the scope of the problem and to confront it.

Copper, a metal with high thermal and electrical conductivity, is the essential ingredient in power lines, heating and cooling pipes, and grounding wires—the basic components of the modern world. If power lines get stolen, roads go dark. If cell towers get raided, calls get dropped. If electrical substations are knocked over, power goes out just about everywhere, including at police stations.

All of that happened in Dallas: Between 2002 and 2007, reported metal thefts spiked almost 1,000 percent, to 3,339 per year. That number dipped in 2008 but was still around 2,400. Using a toolkit of wrenches, work gloves, and power saws, crooks were dismantling the city—even prying bouquet vases out of local graveyards. "They used to say thieves would steal anything not nailed down," says Dwyer, who ran metal theft field operations from spring 2007 until late fall 2010. "Now even if it's nailed down they want it."

Since 2001 the price of copper has gone from less than $1 per pound to about $4 per pound on the Comex division of the New York Mercantile Exchange. In response, looters and scavengers nationwide are stealing copper where they can. Within the last three years, copper thieves have disabled 130 cell tower sites across 17 jurisdictions in eastern Virginia and North Carolina. They stripped the wire from an airplane control tower in Ohio, endangering in-flight communications. They scuttled the irrigation system of Pinal County, Ariz., causing $10 million in damage and ruining a harvest. In Indianapolis, gutted refrigeration systems cost the state's largest food bank $400,000 in spoiled rations. In Jackson, Miss., thieves stole the copper from five storm sirens, which then failed to warn residents of an incoming tornado. In Kansas City, Mo., power outages due to stolen wire caused a credit union to freeze bank accounts, while a separate group allegedly used a backhoe to excavate 18,000 feet of backup power lines worth at least $500,000. In western Nevada, bandits on four-wheelers took out signal and control systems from Union Pacific and Amtrak rail lines. In Minneapolis and Cincinnati, police say gangs use foreclosure lists like treasure maps, looting pipes from hundreds of homes, some of which exploded from gas leaks.

The biggest cost isn't what's being taken—it's fixing the damage. "For every dollar stolen, it's $10 to $25 worth of repair," says Ralph Anderson, who helps utilities protect their property as a risk specialist at North American Electric Reliability, an industry consortium. In 2008, according to a survey by the industry-sponsored Electrical Safety Foundation International, utilities experienced an estimated 50,193 incidents of copper theft nationwide, resulting in an estimated $60.4 million of damage. (An informal search of local news headlines nationwide turns up dozens of would-be thieves electrocuted while trying to steal live lines.)

A 2008 FBI report, *Copper Thefts Threaten U.S. Critical Infrastructure*,

> **"They used to say thieves would steal anything not nailed down," says Lieutenant Dwyer. "Now even if it's nailed down they want it."**

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Detective Gamez surveys the inventory at Claxton Recycling in Dallas

warned that the persistent, widespread theft "presents a risk to both public safety and national security." The biggest problem, says Eric Ives, special agent for the Bureau's major theft program, is that any recovered material is often untraceable. In order to prove something is stolen, "you have to have a victim, to prove where the copper came from," Ives says. "If you don't have a victim, you don't have a theft."

Guarding an entire country, or just a city, is expensive. In California a group of police departments built a scrap yard to use as a front for gathering contraband and tracking shady vendors. Total cost: $255,000 for 140 suspects. And that was only a stopgap.

Dallas doesn't have that kind of money or manpower. Formed in the mid-'90s, the Dallas metal theft squad mostly consists of a commander and four agents, though they're operating with just three agents now.

An early problem with detecting stolen copper, in particular, was figuring out where it came from. "There is always stuff where you say, 'What the hell is that?'" Dwyer says. To help understand what was going on, the crew pulled some of the smarter cops off their regular burglary or homicide assignments. Most were independent guys who liked the idea of working in street clothes on their own projects. Together they figured out that many metal parts have casting marks, small imbedded brands that name the manufacturer. They started sending pictures of each unidentifiable item to the manufacturers asking for descriptions of what certain products were used for and where they were supposed to have been delivered. "Eventually, just like a neighborhood patrol officer, you learn what looks suspicious," says Dwyer. It took years to become competent. When they spotted a trend, the metal unit would alert patrolmen about what sort of break-ins to be on the lookout for or how to spot homegrown chop shops; crooks, for example, like to melt the insulation off wire, so it helps to look for burnt barrels or acrid smoke.

In early 2008 detectives started to focus on scrap yards, where stolen copper may be turned into cash. One weapon was a new piece of policy: In May 2008 the city revised City Code 40-B, which deals with secondary recyclers, giving the police power to inspect once-private secondary-metals shops. (Secondary metals are recycled metals.) Dallas recyclers had to tag and hold incoming copper for at least five days for police inspection. The cops could remove and investigate any item for up to 60 days if it looked suspicious.

At Mid City, each suspicious item dropped off by the undercover agents was marked in green paint or with a series of unique crimp marks. (Mid City did not return calls and e-mails requesting comment.) By the time police inspectors with proper badges showed up for scheduled visits to look around, they noticed that many of the items were stashed away and some had disappeared altogether. The trick was showing that this was something more than bad management.

Dwyer had a plan for that. Yards are required to check and record IDs of sellers, so in early July he handed one of his officers, a well-muscled man in his 40s with a shaved head, an ID card for a man named Felipe Rodriguez. The alias on the ID was a skinny kid about half the man's age. The officer seemed skeptical as Dwyer issued his order. "Next time you go in," said Dwyer, "let's push this to see how far out of whack they really are."

On July 8 the incognito officer used his bogus ID to make a sale. The clerk wrote up a receipt as usual, and the cop left with the proceeds. Five minutes later, though, the officer returned to the store thinking his cover was blown. In his nervousness, he had forgotten his ID at the counter.

"Felipe?" The cashier asked, cracking up.

"Sí," said the officer.

"No, not you," the clerk said mockingly as he passed the card back so they could keep doing business. Finally, the metal squad had its case.

The copper problem is, of course, one of supply and demand, and the quantity of theft tracks the price on the markets. Right now the supply is in

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Crooks carry cell tower maps like treasure hunters

the U.S. and demand is in China. American demand for refined copper peaked at about 3.3 million metric tons in 2000 and has dive-bombed since, to an estimated 1.8 million metric tons in 2009, according to the Copper Development Assn., a trade group for the copper industry. China, meanwhile, crossed the 3 million-metric-ton threshold in 2003 and has increased consumption by 15.5 percent a year since, mostly because of massive building projects like the Beijing 2008 Olympic Games, and booming industry, according to John Mothersole, a metals analyst at IHS Global Insight.

In 2009 the U.S. shipped an estimated 843,000 metric tons of used copper—enough to make about 18,000 Statues of Liberty—largely to China. For the first nine months of 2010, the U.S. has shipped 20 percent more than it did during the same period a year earlier, according to the Institute of Scrap Recycling Industries, a Washington-based trade association that represents recycling yards internationally. About one-third of all copper goes toward pumping out flat screens, smartphones, and iPads that are then shipped worldwide, mainly to Americans. Much of the rest goes to building China's own power lines, cell phone towers, and heating systems.

"There has been tremendous growth while there is tightness," says Mothersole. "The former peak is now the floor, and we'll continue to see record gains." Last December copper futures reached a 30-month high of $4.03 a pound on the Comex. Lannie Cohen, president of Capitol Commodity Services in Indianapolis, estimates the price will reach $5.08 in 2011. The U.S. produces about 31 percent of the world's total secondhand copper supply, according to Mothersole. Internationally, that secondhand supply accounts for 16 percent of all refined copper being used in manufacturing. Mothersole calls all that "the aboveground mine."

For the copper pirates, there's plenty more stuff to jack. Bob Garino, commodities director at the Institute of Scrap Recycling Industries, estimates a surplus of 125 billion pounds sitting around in unoccupied developments, blighted buildings, and discarded consumer products. That increases by about 1.8 billion pounds per year, he says. Until now there hasn't been ample incentive to go get it. "One feature of scrap is the price is elastic," says Garino, meaning that people don't bother to steal copper when it's cheap. "You bring in a lot more at $4 a pound."

The more a scrap yard processes, the more it profits. In this way, Dallas' 22 scrap yards resemble another venerable Texas institution: cattle feed yards. Smaller lots sell to midsize lots, which sell to bigger yards. In the cattle world, cows get fattened at each stop before butchering. In the copper trade, something similar happens. The metal is generally cleaned, stripped of insulation, chipped into smaller pieces, or baled into bigger bundles for easier transport. Much is sold to exporters operating out of Houston or Galveston, both less than 300 miles from Dallas. When it reaches China, it is generally refined and put back into production.

On a recent mid-October afternoon at Action Metals, a scrap yard in south central Dallas that operates out of a lot the size of a sprawling suburban backyard, Dwyer appears for a routine inspection. At the yard that day is a trio of Chinese investors who have showed up to discuss shipping directly to China.

Sporting Prada glasses, Action's debonair manager, Boris Grinstein, says most of Action's copper comes from plumbers and electricians who are making spare change off job leftovers, as well as a few street peddlers who scour the streets for discarded junk they can sell to help stay afloat. "We are very very open with the police," says Grinstein. "Everything that comes in here we show them. We are the first people who don't want to buy [stolen goods] because it puts a bad light on us." Dwyer agrees, noting that good shops help collar crooks while taking credit for the busts.

During the inspection, Dwyer, in uniform, watches a service worker pitching huge handfuls of speaker wire into a screeching metal granulator the size of a Volkswagen. The Strip-Tec 400 costs $67,500 and chops the wire into glittering specks that move along a small conveyor belt. It can process up to 475 pounds per hour. Everything spills into a bucket that is pitched into a larger metal drum. This is why the theft unit wants to inspect copper at the first point of sale. Over the hum of the machine, Dwyer shouts, "Once it gets into yards and gets processed, it becomes invisible."

A few months after the sting at Mid City, Dwyer presents his case before the city's Permit and License Appeal Board, a council made up of local business owners. The yard has racked up 18 different administrative violations, including allowing sales with improper identification and piggybacking multiple transactions onto the same receipt to conceal sellers' identities. The police choose to appear before a public board rather than a criminal court because the burden of proof is easier. Felony convictions for taking in contraband require each purchase to be worth $1,500, and officers have to blatantly state while working undercover that the goods they are hawking are hot. Do that enough, and criminals tend to get suspicious. Also, because jails are overcrowded, first-time felony convictions often result only in fines or probation.

Dwyer wants a 30-day business suspension. The board settles on 15 days. The financial impact on Mid City is hard to determine because the police don't know how much illegally obtained metal they move. Dwyer doesn't like to speculate. "How much is moving though undetected? By definition, 'undetected' means you don't know," he says.

The yard, however, will have to hold whatever it has. "That's where it hurts them," says Dwyer. The severity of each suspension, of course, hinges on a force beyond everyone's control: the market. So far Dallas has suspended three other salvage yards for a few days each for trafficking violations. While that may slow the tide of stolen product, it's raising the ire of metal trade organizations that think the government has no business regulating private businesses. "It's just a huge nuisance," says Garino at the Institute of Scrap Recycling Industries, which has started a website to let police,

PHOTOGRAPHS BY JARED MOOSSY FOR BLOOMBERG BUSINESSWEEK

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industries, and yards share information about missing material. "The companies that rely on peddler trade are getting this mixed bag of material they need to sort through," he says. "The last thing you need to do is park it on the side of a lot for days," especially when prices can shift up to 20¢ a day. "That's a huge cost to the small scrap processor," says Garino. Dallas' scrap monitoring board seems to agree. As with his Mid City case, most of Dwyer's suspension recommendations are cut in half.

The new regulation has helped the metal theft unit expand its detective work in other ways. The ordinance requires scrap yards to keep photos of sellers with both their merchandise and their cars, which offers a nice Rolodex of potential perps in possession of stolen goods and vehicles. "It's common to find that the person selling has a criminal history of some type," says Dwyer.

It's likely tens of thousands of so-called transaction photos now exist, though all are held separately at individual scrap yards. Now the unit can start at the yard and work backwards: Figure out who brought the suspicious copper in and where they got it in the first place, and you have your victims—and your case.

On a chilly fall morning, Dallas detective Jerry Gamez and his partner, Jim Winkle, arrive for a routine inspection at Claxton Recycling, a midsize depository that manager Sue Benton says processes about 500,000 pounds of copper each month. Benton describes her relationship with the metals unit as "absolutely a good one," and even hangs a Dallas police department jacket off her office chair.

Still, this is where the metal goes, so the police are there. The detectives don work gloves and pick their way through rows of metal-filled laundry bins inside the hangar-size storage room. Gamez wears a shiny belt buckle, a vest to conceal his gun, and a dusty Rangers cap. Winkle wears aviators and a gun in a hip holster and chews a fat plug of tobacco. Neither has fired his weapons while on metals duty, though they have had to chase suspects and wrestle them to the ground. Not that they always spot the bad guys. "About 80 percent of what is out there is legitimate," Gamez says. "The other 20 percent we have to find. I'm looking for that 20 percent—and of that 20 percent I'm lucky if I can find two things."

Both are serious about improving those odds. Back at the station, the crew has pushed desks together to form a long countertop. While the burglary and homicide desks in other parts of the room are covered with fitness or gun magazines and have a nice view of a flat screen tuned to ESPN, the metal detectives spend hours poring over an evidence locker's worth of recovered sprockets, levers, and cables spread across their desks. The detectives are trying to figure out where each piece comes from and what it might look like if hastily removed. Do that long enough and you start to view the city differently. The metal theft unit now knows the function and street value of any set of overhead lines based on their height, arrangement, or thickness. They can tell you which buildings might be easy targets—like small churches, which may only be occupied on Sundays—and which protective measures are generally worthless. Boarding up a building, for instance, makes it harder to spot the bad guys gutting it after they get inside. Some of the team's desks sport *Iron Man* action figures, a badge of honor that veterans give out to recruits who learn to "talk metal."

At the Claxton yard, Gamez scans the shiny wasteland. He considers checking out an uprooted lamppost but can't; the inspection period has expired. Gamez shrugs. Sometimes good leads get buried—literally—in the piles of debris. He settles on a bin of roughed-up piping. "See how it's all scratched up?" he asks. "Someone used a vice grip to break this—that's not the proper tool." When a clerk traces the bin number, they learn that the load came in at 4:22 p.m. the day before—41 pounds worth $1,389.30. After they pull out a picture of the seller and his pickup truck, a scale operator recalls that the seller claimed it was refrigerator coil found in a dumpster.

During the inspection, Gamez works the room like a jovial bartender. "Layla? I got work for you!" he says when he needs a record. "Clemente! He's a scale guy! One of the best!" he adds when he gets some nice bit of intel. It might not seem necessary, but a good rapport is a must. "You want them to respect you so much that they comply with the rules even if you're not around," he says.

When Gamez gets back to the office, he will check out his suspect's work history and address. Then he'll call former employers and rummage through police reports to see who around the suspect's neighborhood might have been robbed or if the truck was reported as a suspicious vehicle somewhere.

Private companies like enforcement to start at the yards, too. In the Dallas area, AT&T prints serial numbers on coated lines and marks grounding plates on cell towers with ultraviolet ink that can only be spotted with a black light. Oncor, the region's largest utility, has experimented with nanotechnology to brand transformer coils with microscopic bar codes that won't scratch off. Those measures are meant to help police quickly trace parts to where they were installed and deter thieves from messing with the utility's copper.

The new, yard-based approach to solving copper theft is paying off. A recent sale at Claxton was tracked to someone who had created a fake work order to unload 99 reels of insulated copper for $14,877. "I know I didn't do anything wrong. People get the wrong picture that we are buying stolen material knowingly. We hold everything for the detectives," says Benton, letting the police make the choice about what's suspicious. In this way, she explains, it helps the buyer as much as the seller. "They help me stay out

Action Metals in Dallas; a Claxton customer awaiting his paperwork



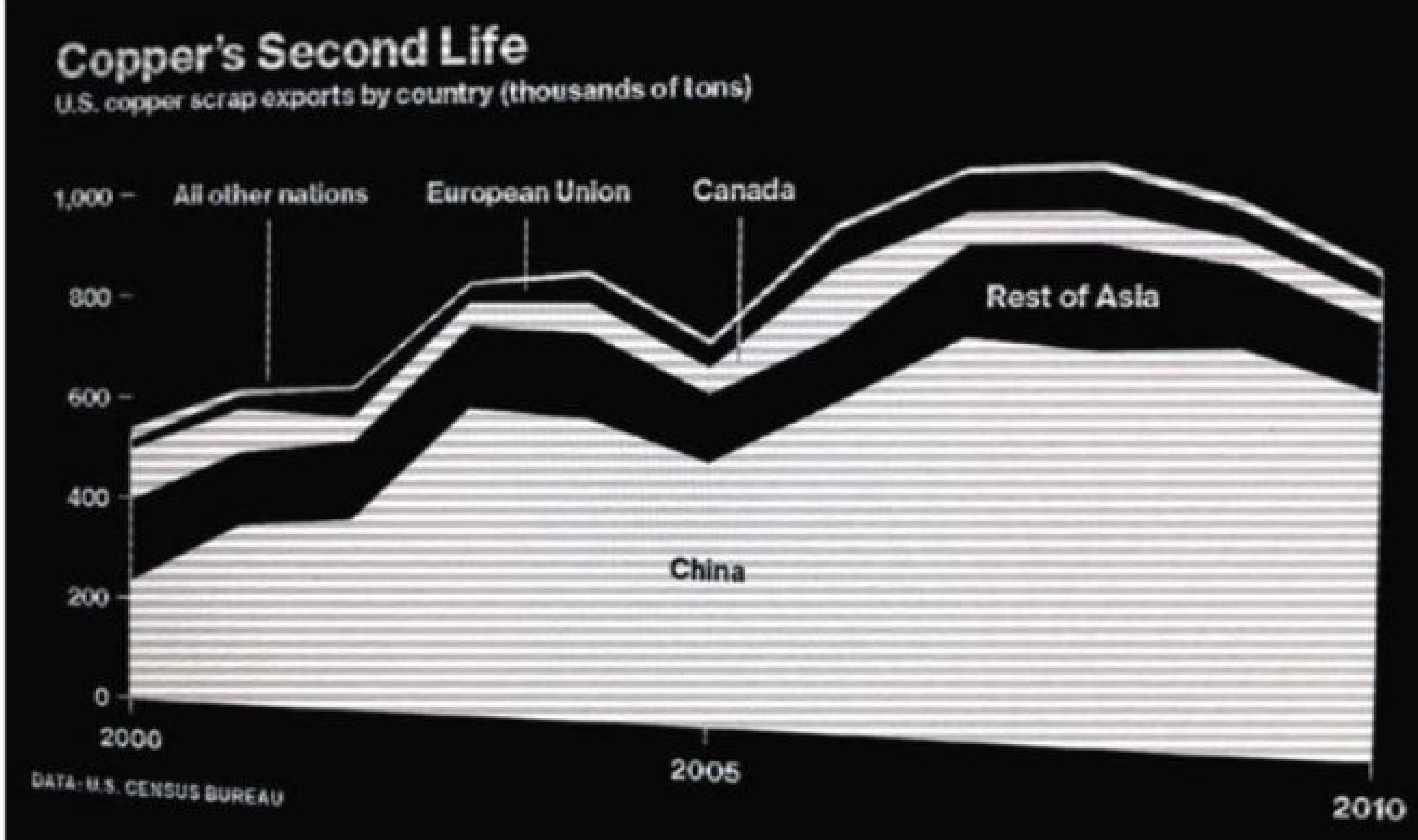


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of it because I don't want to accuse the people who come in of stealing." At another yard the unit nabbed two guys trafficking their plumbing company's piping for $6,256.

Dallas' focus on the problem has produced a model for other cities. While the metal unit cracks only about 10 percent of reported cases, there has been improvement in the overall numbers, partly because of some new state sentencing guidelines. In 2009, Texas made it a felony to interrupt any public utility or transportation line, or to possess stolen copper tubing or condensers. In April 2008, Dallas was averaging more than 300 reports of metal theft per month. In 2010, reported thefts are running about 130 per month—still about four every day.



Plenty of suspicious sales continue to get through. Gamez scoffs when he inspects one suspect's buying history. Over the last month the man has conducted 10 separate transactions worth a total of more than $10,000, all during business hours. It's the profile of a true scavenger: works alone, probably unemployed, opportunistic. "Will they catch him? Probably not," Gamez says. "We'd have to follow him around all day long, and we just don't have the manpower."

Meanwhile, those blind spots have opened the door to some privately funded reinforcements. In 2006, AT&T partnered with a copper-specific video alarm company in Dallas called Videofied. When tripped, a battery operated camera sends 10 seconds of video footage to officers over a cell signal. It can operate even if the power and phone lines are cut.

Mike Korbuly, vice-president of SNC Security, who responds to incidents in Dallas for Videofied, has caught bad guys carrying their own cell tower maps, a takeoff on the foreclosure list treasure-hunting scheme. Standing beneath a cell tower in the middle of a field in north Dallas recently, Korbuly notices the ultimate endorsement. The grounding wires for two other cell companies located at the tower are missing. His are not. "People are starting to learn that AT&T is protected," he says, eyeing an empty beer can the thieves might have left behind. That's helped AT&T reduce service cuts by 75 percent nationwide in 2009. In 2008 those incidents cost $7.3 million, vs. $2.2 million in 2009. Another Dallas company, CopperWatcher, provides air-conditioning unit alarm systems that trip if there are spikes in voltage, a telltale sign of tampering.

Dwyer doesn't think too much about Mid City anymore. The yard went out of business last spring after the police clampdown, and he's working in a different division now. He's also teaching the Dallas model to other jurisdictions. He recently helped Orlando design a system that requires all yards to pay customers via check in an attempt to slow down drug users seeking cash for a quick fix.

That rule hasn't passed in Dallas. Although Dwyer suggested the city include such a plan in the new ordinance, the city council decided to sponsor a lighter "cash card" addition to ordinance 40-B. The first payment for each sale is mailed by the yard to the seller, along with a yard-specific ID card to help track future cash sales. Dwyer has been traveling to Austin to testify for stronger state legislation, and he has opposition. Last year many of Dallas recyclers helped form the Recycling Council of Texas, a lobbying group to oppose moves like statewide no-cash sales.

The biggest problem facing Dallas, however, is that crooks don't have far to commute. Two blocks outside the southern city limits, and Dallas police jurisdiction, there is a junkyard that hoists and sifts metal across a mini-mountain range the length of a football field. Trucks loaded with scrap metal are usually backed up in the delivery area. They have picked up a lot of new business.

Although some personnel have been reassigned—police work has been hit by the economy, too, says Winkle—the metal theft unit keeps on. By November, Dwyer and one of his detectives had been moved to other divisions, and another officer is slated to retire soon. Until more are assigned to the unit, that will leave just Gamez and Winkle to split up and inspect all the city's scrap yards. Gamez isn't excited about the prospect of snooping around solo. "If some of these buyers have stolen property, that makes them felons," he says. Gamez likes having backup. Winkle agrees. Now he's pleased they get to roll in plainclothes and unmarked police trucks. At each yard, Winkle parks his truck carefully so he has a good view of the operation. He tends to chuckle when other cars honk; they often think he's another peddler trying to cut in line.

Back at the station, Gamez fields a phone call from a man screaming that his house has been stripped of copper. He wants a full-scale investigation and a translator to interview some neighbors. (He hasn't given Gamez a chance to say that he's bilingual.) Gamez puts one hand over the end of the receiver and calls over to Winkle. "He wants to monopolize my time," he says. Winkle leans back, spotting the prize trophy in their evidence stash, a larger-than-life copper John Wayne bust. He spits a plume of tobacco into a plastic cup and chuckles. "He won't," he says. The guy's copper is probably already at a metal yard. Now they just have to go find it. B

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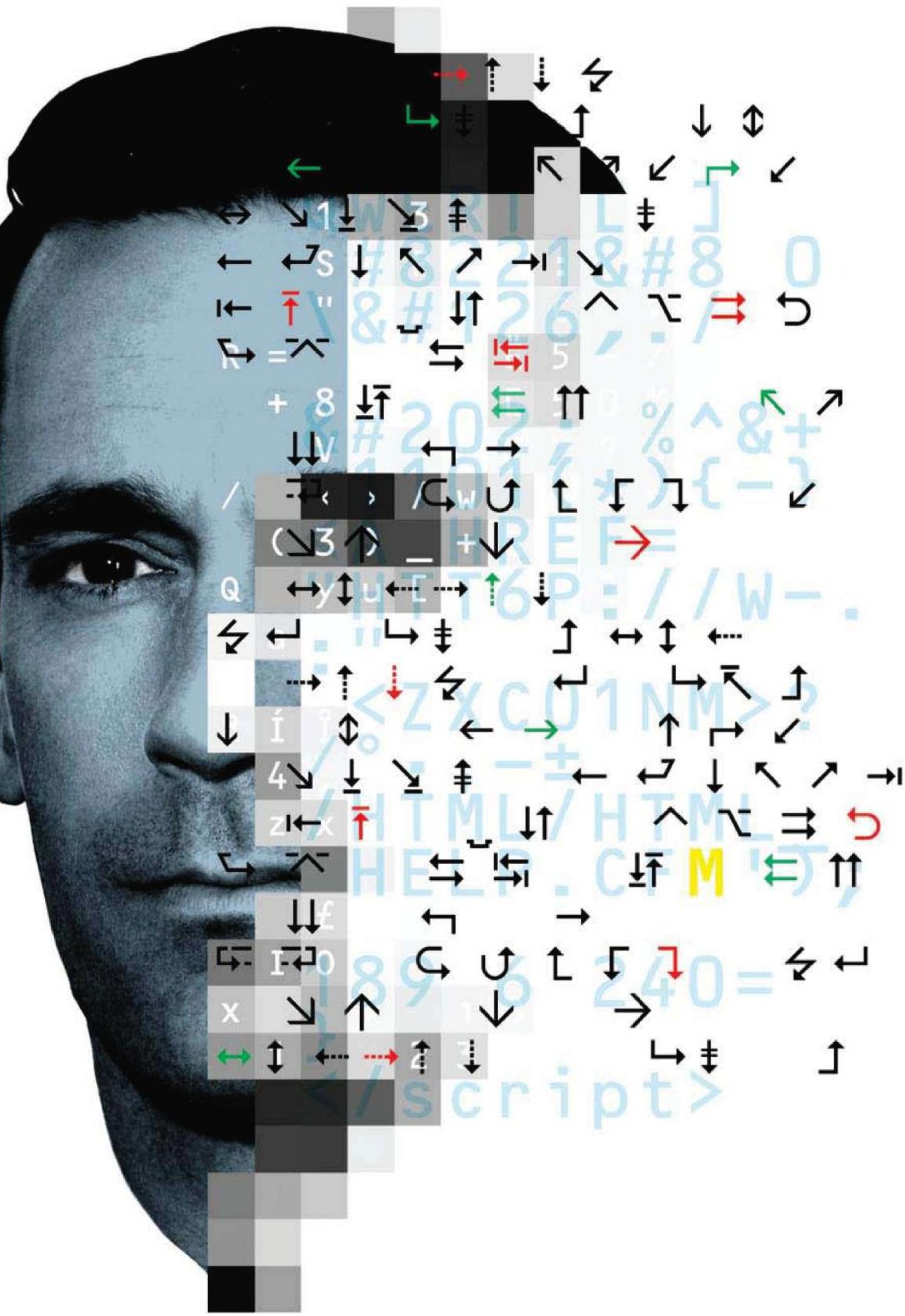
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EVERYONE IS WAITING FOR THE BIG FOUR ADVERTISING GIANTS TO FADE AWAY. BUT IT TURNS OUT THAT BEING A LUMBERING BEHEMOTH IN A DIGITAL WORLD HAS ITS ADVANTAGES.

DON DRAPER'S REVENGE

BY FELIX GILLETTE

ILLUSTRATION BY JOE MAGEE

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JOHN SEIFERT, THE CHAIRMAN OF OGILVY & MATHER NORTH AMERICA, SHAKES HIS HEAD. IT DRIVES HIM CRAZY, HE EXPLAINS, WHEN PEOPLE PORTRAY CONTEMPORARY NEW YORK ADMEN AS SUSHI-MUNCHING, SCOTCH-SLURPING DINOSAURS,

far removed from the concerns of digitally connected consumers and out of touch with a changing industry. It happens a lot.

It's the second day of Advertising Week, the industry's bender of panels, parties, and awards shows, held every fall in Manhattan. Seifert is sitting on a short stage, in a dim room with low ceilings at TimesCenter's The Hall, not far from Times Square. Rows of conventioneers in foldout chairs are watching the event, entitled "Inside a Big Dumb Agency."

Joining Seifert on stage are two colleagues from Ogilvy & Mather—a full-service global agency that is owned by the WPP Group, the behemoth holding company, which has some 100,000 employees in a constellation of agencies around the world. The Ogilvy executives are taking turns calmly responding to belittling inquiries from critics—"How many Twitter followers do each of you have?" one asks pointedly—questioning the relevance of a large, traditional agency in an age when low-to-the-ground, hand-to-hand grappling with consumers, tweet by tweet, is all the rage.

Isn't it amusing, one critic asks, that Big Dumb Agency managers, while enjoying "working dinners" at the swank Japanese restaurant Nobu, brainstorm how to sell cornflakes to single moms in Mississippi?

"I don't know how many of us are sitting at Nobu anymore drinking really expensive wine and talking to clients about things that we know nothing about," says Seifert.

At Seifert's feet rests a copy of *Confessions of an Advertising Man*, the seminal 1963 book by David Ogilvy, the firm's charismatic founder and one of the giants of Madison Avenue's heyday. Ogilvy drove a Rolls Royce. He wore a cape. He entertained clients at his château in France. He did not follow mouse clicks. By comparison, today's New York admen look more henpecked than cocksure.

From the stage, Lars Bastholm, Ogilvy's chief creative officer for New York, says that growing up in Copenhagen, he always dreamed of someday partaking in the Madison Avenue decadence. "This is wildly disappointing," he says. "I was looking forward to those dinners at Nobu."

"If any dumb agency is sitting here thinking life is wonderful," says Seifert, a few minutes later, "I'd be shocked."

The global recession roiled ad agencies of all sizes, but the current climate seems particularly fraught—emotionally and psychically—for the Madison Avenue giants. New York ad executives find themselves navigating a lean world where the flat 15 percent commission (and all the indulgences that came with it) has long since disappeared. Penny-pinching procurement officers now tightly monitor client expenditures, driving down fees; tiny startup interactive agencies moonwalk through award shows, egged on by an adoring press; and California-based search engines and social media newcomers are gobbling up large chunks of market share, selling ads one by one.

Again and again, the executives on stage assure the members of the audience that they get it. The Internet is important. Digital matters. And so they are carefully, painfully reconfiguring their workforces to take advantage of the changing landscape.

The crowd seems skeptical. A young man stands up and reports that he recently saw a list of top agencies around the world, including Ogilvy, that don't have their websites available on mobile devices, including the iPad and the iPhone. "So with the growing importance of those devices," he asks, "why aren't you guys practicing what you preach?"

Bastholm says that he too saw the gotcha list. But the problem highlighted therein, he says, turned out to pertain to a tiny slice of Ogilvy's website. It was easily fixed. "That list was done with a little bit of malice," says Bastholm. "Those lists are always done with a little bit of making a point in mind, rather than actually being entirely true."

Nearby rests a discarded copy of a glossy trade publication, featuring a front-page image of Don Draper, the protagonist of AMC's scripted drama *Mad Men*, which is set in the world of Madison Avenue in the 1960s. "Advertising Week,"

Mad Men Through The Ages

1950s



In the '50s, television emerges, but most commercials are still live, and many shows are sponsored.

"All these little companies with fun names," says BBDO Chairman Lubars, "we've kicked their butts."

ILLUSTRATIONS BY JON STICH

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reads the pull quote, "the second-best recruitment tool for the industry behind Don Draper."

In *Mad Men*, Draper is a lusty, brilliant, troubled creative director conquering Madison Avenue thanks to his emotional insights into the subconscious motivations of consumers. Along the way, the archetypal Ideas Man seduces everything in his path: department-store heiresses. Bra manufacturers. Kodak executives. Secretaries. He is an unapologetic hustler. When a belittling beatnik asks him how he sleeps at night, Draper responds: "On a bed made of money."

Mad Men landed in American living rooms at a time of rising anxiety for creative types in New York advertising, with the balance of power in the industry feeling like it might be forever shifting to Silicon Valley. In 2007, the year of the series' debut, Google generated more than $16.5 billion in revenue, largely from advertising created entirely without creative directors. It brought in $23.6 billion in 2009. The *Mad Men* fantasy offered a counterpoint to a connected world where analytics and mathematical marketing promised at long last to erase the mystery from advertising, and a lot of the profits.

Nick Law, the chief creative officer in North America for the interactive ad agency R/GA, is standing on stage at another Advertising Week event, delivering a lecture entitled "Designing an Agency for the Digital Age." Law, dressed in a snug, black V-neck T-shirt, clicks a button and an image appears on the screen behind him. He tells the audience that the hieroglyphics in the picture represent the old model of advertising: A chess piece + a lightbulb x a TV-shaped box = an exclamation point. Law translates the simple equation: "Strategy + creativity x mass media = ambiguous results," he says.

The dig at the traditional agency model scores a chuckle from the crowd. Law clicks the button again. A new formula appears on the screen. This one, he says, represents the new model of advertising in the Digital Age. It has a bunch more variables and looks like the precocious love child of the quadratic equation and the Rosetta Stone.

"It's basically something like: Collaboration + data + strategy plus creativity x media neutrality times efficient production = measurable results," says Law. "Of course it's purposely complicated because we want to pretend like it's a lot more difficult than it actually is," he says. In one clever illustration, he has managed both to send up the bewildering pretension of the forward-looking digital agencies and to embody them perfectly.

Law goes on to explain that the old model of advertising is no longer working. The modern digital world has seen a multiplication of contexts, he says, from e-mail to search engines to blogs to social media networks and on and on. Companies can no longer simply wait for a potential consumer to sit down in front of the TV and then interrupt them with a message. The upshot for clients, he says, is that mass marketing no longer reliably delivers increased sales. That means that old-style agencies have little to offer.

1960s



By the '60s, armies of irreverent executives are trying to match the wit of ad legend Bill Bernbach.

Furthermore, if mass marketing no longer works, then micromarketing to niche behaviors and interests must be the answer. That is what has led to the proliferation in recent years of little ad shops, instantly recognizable by their professed disdain for traditional—and profitable—mass marketing, and their penchant for wacky names: LeapFrog, GeniusRocket, Big Spaceship, glue isobar, Blue Barracuda.

The key, according to the new paradigm, is to create interactive brand experiences that recognize and enhance consumers' online behavior. If hard-core joggers are using the Internet to log the mileage of their daily runs with their iPods, agencies should build a sponsored home for them online where they can track their data, visualize their progress, and plunk down serious coin for premium running shoes. That was the basic idea behind R/GA's interactive campaign on behalf of Nike +.

1980s



No ideas? Buy some. The '80s are all about mergers, starting with WPP's purchase of JWT in 1987.

All of this will be undertaken by "digital natives" with the Web in their DNA. Only the small, nimble shops will be able to navigate this fractal universe of endlessly proliferating media. The big guys with their lumbering overseers at the holding companies are not only dumb, they are also as good as dead.

It all sounds great, at least to the technorati. The only problem is, it's not remotely true.

"All these little companies with fun names," says David Lubars, "we've kicked their butts." Lubars is chairman and chief creative officer of Omnicom's BBDO North America, an 82-year-old Madison Avenue agency with more than 17,000 employees. On a recent Friday afternoon, Lubars was sitting in his Midtown Manhattan office. He gestured at BBDO's 2010 Webby award for best ad agency of the year, which was resting a few feet away from his electric guitar, tuned to imitate Keith Richards' ringing sound.

"Americans like a story of the big guys getting taken down," says Lubars. "But that doesn't mean that's what is actually happening."

After a couple of years of slumping fortunes, the Big Four advertising agency holding companies—Omnicom, the WPP Group, Interpublic, and Publicis—are bouncing back. In October they reported their quarterly earnings. Across the board, revenues were up. Omnicom brought in $2.9 billion, an increase of 5.5 percent over 2009, including a jump of 8.4 percent in North America. Revenues are once again approaching the lofty levels of 2007. Looking at trends over, say, a decade-long period reveals little evidence of secular decline. The layoffs of the past two years are over. All of the Big Four are

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hiring, prompting columnist Jim Edwards to write a recent post on BNET with the headline: "Help Wanted: Madison Avenue Is Hiring Like Crazy and Bonuses Are on the Rise."

Last year, according to a study by PricewaterhouseCoopers, Internet advertising revenues amounted to $22.7 billion, of which 35 percent was spent on display advertising. In the third quarter of 2010, according to the Interactive Advertising Bureau, online ads reached a record $6.4 billion, up 17 percent from a year earlier. The market is expected to continue to grow.

That's a lot, but it's still a long way from the amount spent on traditional advertising. Based on the revenue opportunities available, agencies would be negligent to devote all of their time to digital platforms. To wit: During 2009, the Big Four combined brought in $16.71 billion in revenue in the U.S., according to *Advertising Age*, more than double the $8 billion spent on digital display advertising in U.S. in the same year, across all companies.

Lubars, dressed in jeans and a black long-sleeve shirt, pops a highlight reel into his office DVD player. For the next 15 minutes he shows off some of the agency's recent work: an AT&T banner ad in which World Cup fans could use their Web cameras to play a soccer game on screen; a 30-second Snickers TV spot starring Betty White and Abe Vigoda; and a multimedia campaign for HBO that included the strategic installation of outdoor multiscreen storytelling cubes in New York and Philadelphia.

"We're doing leading-edge technological breakthrough things," says Lubars. "At the same time, we're winning the best spot for the Super Bowl."

Prior to joining BBDO, Lubars was president of Fallon Worldwide, a Minneapolis-based agency owned by Publicis. He spent the first two decades of his career working in traditional media. In 2001, while trying to figure out how to get potential BMW customers to spend more time on the company's website, Lubars came up with the idea for *The Hire*–a series of eight short films directed by the likes of Ang Lee and Tony Scott, starring Clive Owen. The campaign grew into a monster hit and won Lubars seemingly every major award in the industry. As a result, he has little patience for the idea that veterans of TV and print campaigns are genetically incapable of making a dent in new media.

Not that old agencies sometimes aren't a tad sclerotic. When Lubars joined BBDO five years ago he found a traditional agency curiously eyeing the changes sweeping through the business."Forget about new kinds of media," says Lubars. "They didn't do old types of media. They didn't do print. It was essentially a film production house. They made these shiny, expensive films–which was a great thing to do in that era."

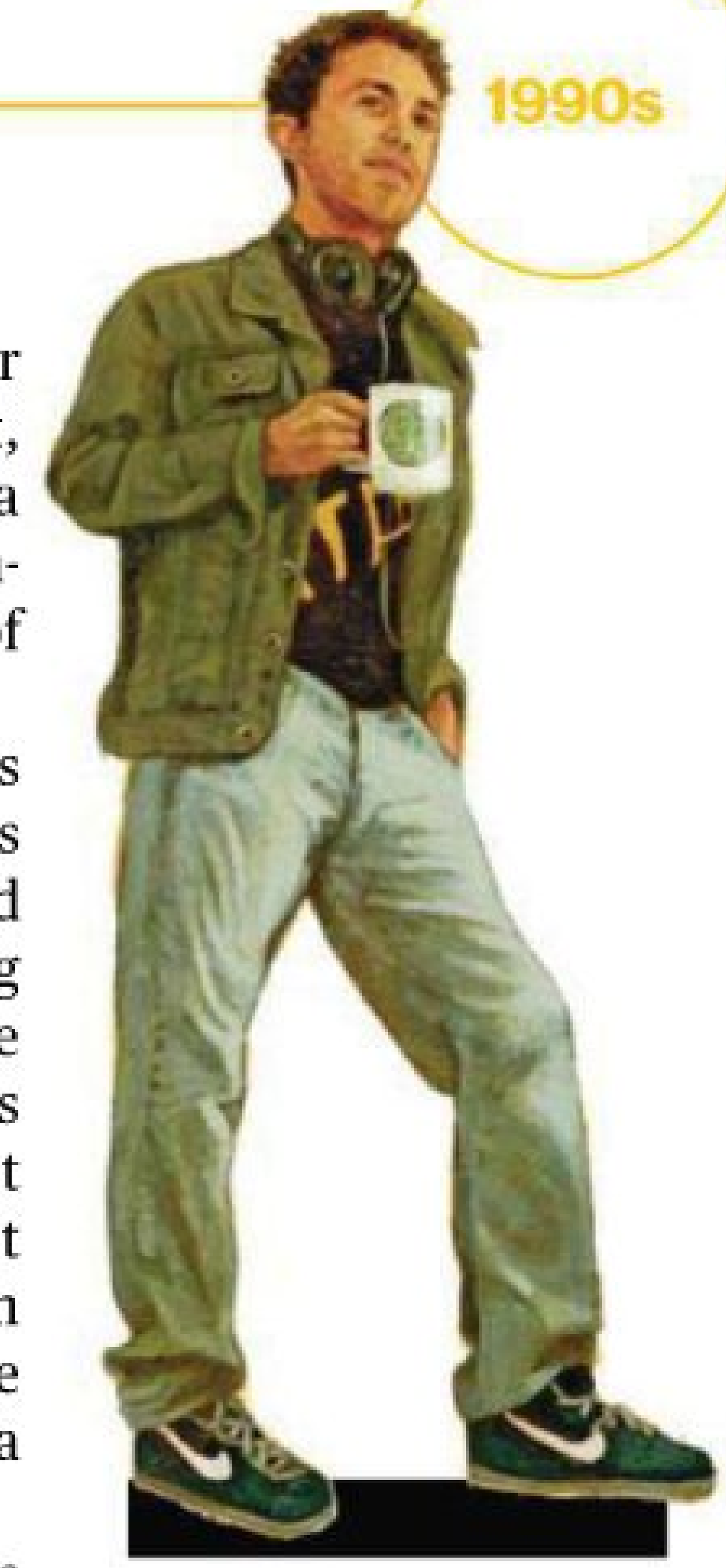
In the intervening years, Lubars has overseen a high-profile transformation of the agency. "It used to be a company with a big fat middle," he says. "Now it's a skinny middle with a lot of young people and just a few managers. We're trying new things. And we're bringing in people who come from different backgrounds–technologists, designers, artists–who come together and create this new, interesting gumbo."

"The last 24 months have been unbelievably painful in our industry," says Ogilvy & Mather's Seifert. "The fact is, what you don't read about in the blogs, is that we let 391 people go. But we also hired 270 new people. We transferred another 300 people between different parts of the company. All of that was designed to meet the changing requirements of our business."

Seifert says that in addition to reconfiguring their workforce, Ogilvy is happy to learn from the small digital shops–and hire away their top talent. "We have more shared ventures going on with young startup agencies right now than we've ever had," he says.

And over time, many of those nimble startup shops end up in the same position as their supposedly ham-fisted forefathers, becoming a part of the big companies they are pretending to outfox. The global holding companies continue to tinker with the mix of services in their portfolios and aren't shy about using their resources to acquire little artist colonies to plug holes in their offerings. In November, Omnicom bought the British design and communications agency The Core. In May, WPP purchased Brazilian interactive agencies Midia Digital and i-Cherry. The same month, Interpublic bought Cubocc, a Brazilian digital shop, its indie cred codified for posterity by a neon office sign: "Cubocc, the Monster Whatever Hotshop."

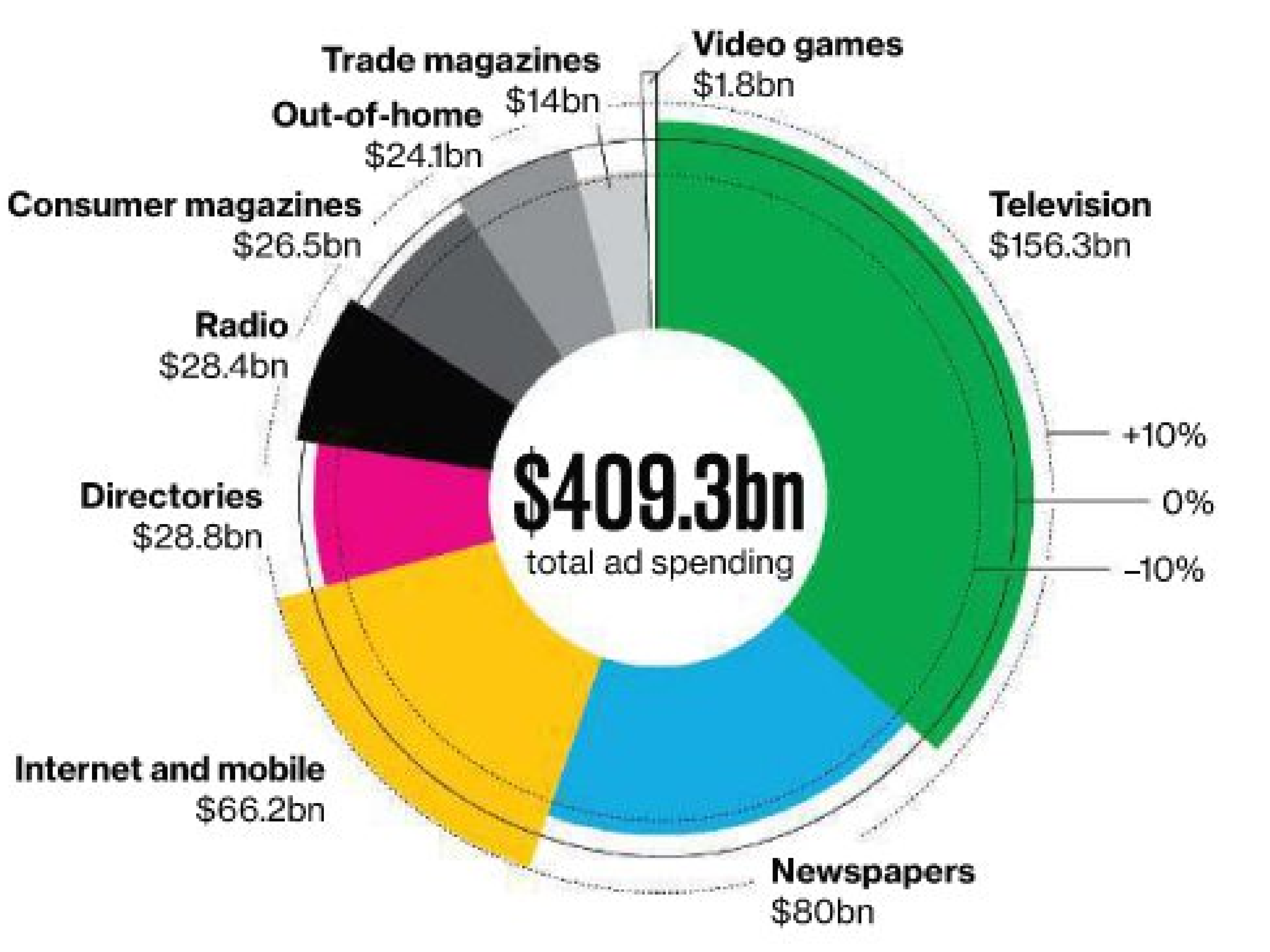
Lubars is also gobbling up talent. In addition to stockpiling search engine optimizers, social media strategists, and Web developers, he continues to add creative digital talent. Right now, the Swedes are the hottest thing in the industry. In February, Lubars hired Mathias Appelblad, a former interactive creative director at the Swedish agency Forsman & Bodenfors, to become BBDO's director of innovation.



In the '90s, the ad world starts thinking digital. Google is founded in 1998. By 2010 it will gross $23.6 billion in revenue.

It's a Mad, Mad (Ad) World

Advertising spending ($ billions) and percent change since 2009



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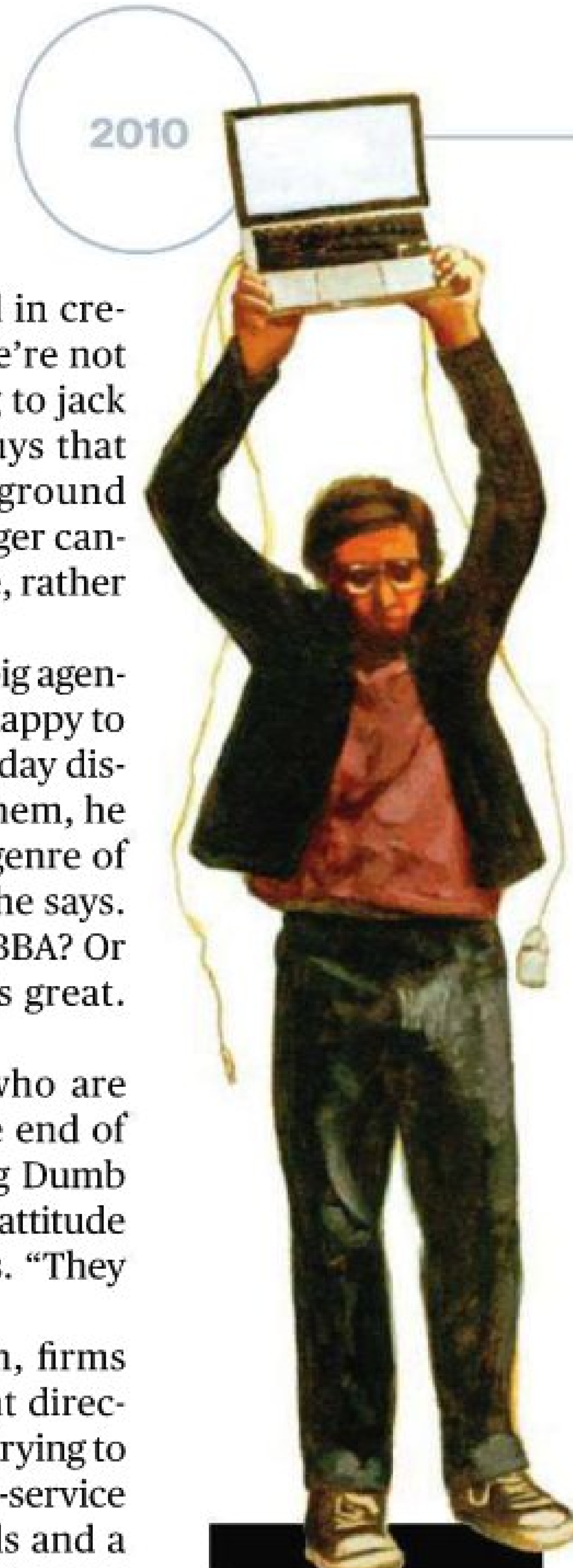
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"He has dominated the digital world in creativity," says Lubars. "Now he's here. We're not going to rest on our laurels. We're going to jack it up that much more. We're adding guys that come from some of these small background places. They come here to paint on a bigger canvas—where it's actually part of the culture, rather than some side dribble."

Lubars doesn't want to defend all the big agencies, just the good ones. He says he'd be happy to watch some of the mediocre giants someday disappear. But writing off the whole lot of them, he says, is naive—like dismissing an entire genre of music. "Oh, you don't like pop music?" he says. "What does that mean? You don't like ABBA? Or you don't like the Beatles? Some of it is great. Some of it is disposable."

The little hot shops, says Lubars, who are thumping their chests and declaring the end of mass marketing and the death of the Big Dumb Agencies, do so as a business posture, an attitude for journalists, and a sales pitch to clients. "They don't believe a word of it," he says.

What he sees instead is an evolution, firms heading to the same place from different directions. Technologically able marketers are trying to scale up into full-service agencies; and full-service agencies are mastering the new channels and a world with 6 billion individual markets. "They're racing to figure out what an idea is," says Lubars. "We're racing towards technology. It's easier to pick up the technology. That's why we got there first. ... They are desperate to take down the agencies that are doing it now."

At the same time, the big agencies are busy integrating their technologists into all aspects of their operations, and hungrily circling the interactive market, plotting to swallow more share in the years to come.

"A lot of the people who are working in smaller shops and kind of lobbing stones at large agencies like this miscategorize us as being people who are in love with doing the TV commercial," says Matt Donovan, managing partner of McCann Erickson, New York. "We're not. We're in love with creativity that moves that big business problem into the positive results column. More and more companies are finding that the big agencies have retooled and do understand this change. We are paid by businesses to outsmart others. That's what we're here to do."

Prior to joining McCann Erickson, Donovan worked at Euro RSCG 4D, an interactive agency. "Back in '97 and '98 when I started in digital," he says, "all the talk was that agencies were going to die. I had a wise CEO who had been in the ad business before television, and he said, 'That's exactly what we thought when television came along.' What you really have to do is engage with this stuff, learn it, and you'll be in fine shape. That's part of the belief of this company. It's been around for a hundred years."

"We are learning from some of the smaller digital shops that are out there," he adds. "I think what they're worried about is when a big agency like this one acts on this and gets it right."

All of the big agencies are working on multiple fronts to integrate their technology teams more deeply into every aspect of the creative process. The days of digital silos inside agencies are long gone. In October, McCann Erickson moved Mark Fallows from London to New York to serve as the agency's director of creative technology. "The mistake that a lot of traditional agencies made in the past was that they just hired some digital people, put them in the corner, and said, 'When we have the ideas we'll come to you and you can build some digital,'" says Fallows. "That's not how it works anymore."

In the darkest moments of 2009, with ad budgets withering away amid the global recession, the age-old despair of the creatives was at fever pitch and the din of the futurists at a near-deafening roar. But as the global ad market continues to thaw, the descendants of Madison Avenue not only are alive but are looking as well positioned as anybody to capitalize on the digital market moving forward.

"We're getting calls all the time now from clients and new business prospects who have gone and worked with alternative, New Age agencies that are now saying we want to come back and talk to you," says Ogilvy's Seifert. "If you believe our critics and the pundits, you'd say, 'Well, these big dumb agencies are built on hubris; they're in Madison Avenue towers; they lack the nimbleness to thrive,'" says Thom Gruhler, president of McCann Erickson, New York. "It's the most ridiculous notion you've ever heard in your life."

Lubars says that rather than filling seasoned admen with dread, the technological explosion has rejuvenated their interest in the game. "I got to be honest—at my age, now, if it were still just TV, and print, and radio, I'd probably be really bored," says the 52-year-old Lubars. "I've done this for 25 years, and what? I just keep doing it? Now every day there are not just new ideas, but new technologies to distribute. It's fun for us. There are all these new things you can do now that you couldn't do last year."

"It's gray and messy right now," he says. "I find that chaos and lack of definition liberating. I think any really good creative person would." B

In 2010, the quintessential ad genius is creative and rebellious—and may already work for one of the Big Four holding companies.

"More and more companies are finding that the big agencies have retooled," says Donovan of McCann Erickson. "We are paid by businesses to outsmart others."

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By Diane Brady. Photographs by Miller Mobley.

The Unknown Guru

CEO coach Stephen Miles, just 43, has quietly built a client list that includes some of the biggest names in business. What makes him so good?

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Miles' Clients Analyze Him: Stephen Elop, CEO, Nokia "You go into these meetings saying, 'yeah yeah yeah, we'll see how well this goes,' but he was adding value within the first five minutes." **Marius Kloppers, CEO, BHP Billiton** "He's fearless in a soft but determined sense." **Brian Dunn, CEO, Best Buy** "Steve understands that human pathology doesn't change." **Shantanu Narayen, CEO, Adobe** "He has these funny sayings like, 'If the horse is dead, you have to dismount' that can become part of your vocabulary."

Anyone setting out to explain the remarkable success of Stephen A. Miles, a rising star in the world of executive coaching, might start with the nomadic childhood that helped turn him into a student of human psychology. Born in Nairobi to a schoolteacher mother and an agro-economist father, Miles lived in South Africa, Iraq, and Argentina by the time he turned eight, then in Canada—New Brunswick, Ontario, and British Columbia—honing his adaptability and talent for observation all along the way. "You have to read people quickly to fit into the social network," says Miles, 43. "My whole world is about trying to read people, to find that one ticket in, and get them to do something differently."

Someone else might point to Miles' years as a young prison caseworker with a master's degree from the University of Victoria, counseling maximum-security inmates at Ontario's Kingston Penitentiary. Caring for an often violent population, he had to explain to clients why they couldn't expect parole anytime soon, or gently convey that they wouldn't be granted furlough to attend a father's funeral. "I didn't like the negative environment," he says. "But it gave me the confidence to tell people anything." Beyond that, Miles is reluctant to discuss his career behind bars. He deflects the question of whether there are useful comparisons between the inmates he worked with then and the chief executive officers he works with today, a list that includes Marius Kloppers of mining giant BHP Billiton, Best Buy's Brian Dunn, Stephen Elop at Nokia, and Shantanu Narayen, of softwaremaker Adobe Systems.

Miles may not enjoy such biographical scrutiny, but it is the method he uses with his CEO clients. "Our first encounter was three hours," says New York Life CEO Theodore Mathas, "and I think we got up to when I was in the seventh grade. He asked questions like 'Did you get your homework done?' and 'Did you spend more time with your mom or your dad?' It was a little unusual." Miles says his goal is to understand what shaped the executives as human beings. "I care less about what they think than what they have done." Says Mathas: "He made me feel comfortable, but it was clear he wasn't there to be my friend."

An arm's-length relationship makes Miles more valuable. After hours of interviewing senior executives and those who work with them, he paints a portrait that can be surprising to the subject—and crucial to their careers. For some, it's the key to getting a CEO job. For others, Miles' insights are indispensable in managing the transition to the top job. And friends or not, they all regard him fondly. "I love him unreservedly," says Kloppers, with a laugh. "He's wicked smart," says Narayen. "It has been fascinating to see the wisdom he brings," says Stephen MacMillan, CEO of medical device maker Stryker, "for such a young punk."

Although he's been consulting for barely a decade, Miles has already developed a client list rivaling those of the world's best-known consulting sages, such as Marshall Goldsmith and Ram Charan. "Stephen is near the top, especially given his age," says Goldsmith, 61, the longtime dean of the executive-coaching set. "He probably has a broader knowledge base than me."

His success has sparked jealousy, too, as well as skepticism. There are some in the business world who dismiss the lucrative leadership-advisory niche as little more than a "rent-a-friend" service, patronized by CEOs who want someone to hold their hands and tell them they are brilliant. Yet the field is growing rapidly. Once limited to solo practitioners and boutique firms, leadership advice is now on the menu at large management consultancies, accounting firms, private-equity shops such as Clayton Dubilier & Rice, and executive-recruiting firms such as Heidrick & Struggles, where Miles serves as vice-chairman in the firm's Atlanta office.

Miles' goal is to understand what shaped executives as human beings. "I care less about what they think than what they have done"



The proliferation of competition irritates some veterans of CEO advising. "Any ex-high school football coach can hang out a shingle and call himself an executive coach," says Thomas Saporito, CEO of RHR International, which has PhD-level psychologists on its staff. "We've been at it 65 years, and in the last five, there are a lot of people moving into our space who hadn't been there before."

Miles doesn't see "the space" as having strict boundaries. It's more art than science, he says. "Most people think you can use a set of tools and apply them against a methodology and out pops the right answer." To the contrary, "leadership comes in all forms, and you get better at assessing it with time. It's like an artisan: You have to paint a lot, and paint at the high end." The work pays handsomely. CEO coaches can earn annual fees per executive of $75,000 to $250,000, according to people in the field. One coach says a really big name can earn as much as $75,000 for a two-hour session—a figure that Miles greets with a laugh. He won't discuss his own compensation, noting only that "our fees vary depending on the length and depth of the project."

Helping rookie CEOs adapt to the new role has become a speciality for Miles. "You don't go to bed the night before you become CEO and wake up the next morning with a pointy hat and a bigger brain," says Best Buy's Dunn. "Steve understands that human pathology doesn't change." Miles works with corporate boards to help them choose and groom the right leader, and he's fascinated by the multiplicity of factors that make a CEO succeed or fail. "My job is to assess people to find out how much potential and capability they have, and whether it fits the needs of the company," he says, adding that nothing is more important than getting succession right. "It's a whole lot of work, but your personal brand and your company's brand is on the line."

When Miles arrived at Heidrick & Struggles in 1999—after leaving prison work, earning an MBA, and spending about a year at Andersen Consulting—the search firm had only a small leadership-services practice. He worked on research papers and internal assessments, also teaming up with colleague Meredith Ashby to interview CEOs and pundits for what became his first book: *Leaders Talk Leadership*. He found mentors in powerful

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Stephen MacMillan, CEO, Stryker "He cares about my success, not his own." **Steven Loranger, CEO, ITT** "Steve's not in here fixing things. He's trying to make great people better." **Hikmet Ersek, CEO, Western Union** "[When I was] a newcomer to Corporate America, he helped me build my network." **Richard Sanders, partner, Permira** "He has this slightly disarming, almost boyish, manner that makes people trust him." **David Crawford, chairman, Foster's** "My advice to him is to take some time off and go fishing."

Heidrick partners like Joie Gregor and John T. Gardner, who introduced Miles to CEOs and directors.

His pivotal moment came in 2004 when then-BHP Billiton chairman Don Argus hired Heidrick to develop a succession plan. Miles interviewed executives and worked with them on the professional-evaluation process known as the 360, as in 360 degrees, a sometimes painful process in which an executive is assessed by those above, alongside, and below him. The initial assignment spanned 18 months and included multiple reports to the BHP board. "Stephen turned the 360 into a development process," says Argus. Along with delivering what Argus describes as astute assessments, Miles helped create a program to nurture new leaders. And he began working with Kloppers, a cerebral South African with a PhD in materials science from Massachusetts Institute of Technology and an MBA from INSEAD. In late 2007, Kloppers ascended to CEO.

One reason Kloppers says he still works with Miles is the consultant's ability to ask tough questions. "Stephen is fearless in a soft but determined sense," says Kloppers. "We all have baseline personalities, and we have to watch how those proclivities manifest themselves to keep them in check." Neither Kloppers nor Miles would apply that observation to how Kloppers handles the CEO job. Miles is typically reticent when asked about his executive advisees, wary of betraying their confidence.

Settling into a leather chair at Ralph Lauren's RL Restaurant in Chicago, Miles has the laid-back manner of a man meeting a buddy after work. He is cheerful, clean-cut, and rarely at a loss for words, showing no strain from having circumnavigated the globe for a quick stop in Chicago, where a storm is about to hit. He asks as many questions as he answers. And when the wine menu comes, he immediately hones in on a particular Cabernet Sauvignon. "We have to get the Stags' Leap," he says. The label is owned by Foster's Group, and chairman David A. Crawford is a client.

Miles is a top-tier frequent flyer on three airlines. "I've never seen a person who travels so much," says Western Union CEO Himket Ersek



Executives stress that in the course of giving advice, he never promotes his company's recruiting business. In fact, several CEOs note that they rarely think about his Heidrick affiliation, though some see the company's heft as a plus. Miles seems to live for his clients, even those he sees in person only once a quarter, with phone and e-mail contact in between. "He has this capacity to stay in touch and be available, wherever he is in the world," says Foster's Crawford. "I just hope he doesn't get overworked."

It's a reasonable concern. Technically, Miles lives in Atlanta with his wife, Kelly, whom he met while in college. She started her career as a case-management officer at Kingston's Prison for Women and now works as an associate principal in Heidrick's leadership-consulting practice. They don't see each other very much, however. In the tradition of the famously mobile management guru Ram Charan, who for years had no fixed address, Miles spends almost all of his time on the road, half outside the U.S. He has earned top-tier status from three separate frequent-flyer programs. (Even the jet-setting corporate downsizer George Clooney played in *Up in the Air* can't match that.) To sustain their marriage, it helps that the Mileses have no children and Kelly endorses her husband's travel needs. "We build in long weekends," he says.

Still, even clients who manage global businesses marvel at his schedule. "I've never seen a person who travels so much," says Hikmet Ersek. The Western Union CEO credits Miles with convincing him to move from Vienna to Englewood, Colo., to take his current job. Ersek had never worked in the U.S. "It's more of a U.S. thing to have someone like Stephen working with you," he notes. Compared with their European counterparts, "U.S. companies and boards are more open to outside consulting," he adds. "I think it gives you a wider view."

CEO coaching, though, continues to have a mixed reputation on both sides of the Atlantic. ITT's Steven Loranger echoes some of Miles' other clients when he says, "I have a historically jaundiced view of leadership consulting, and Steve is the exception." While legendary management theorist Peter Drucker validated advisory work, helping leaders from Procter & Gamble's AG Lafley to General Electric's Jack Welch, the profession can still evoke images of hucksterish motivational speakers and earnest sidekicks offering self-evident tips. Some skeptics resent Heidrick's muscling into counseling. They argue that a recruiting firm primarily interested in scoping out executive talent shouldn't be trusted to do coaching. "Once you have information about talent, it's hard to have that information not seep into other areas," says veteran recruiter Peter Crist. Leadership consultant Geoff Smart calls it "a structural conflict," though he admits that he's impressed with Miles' "commercial success."

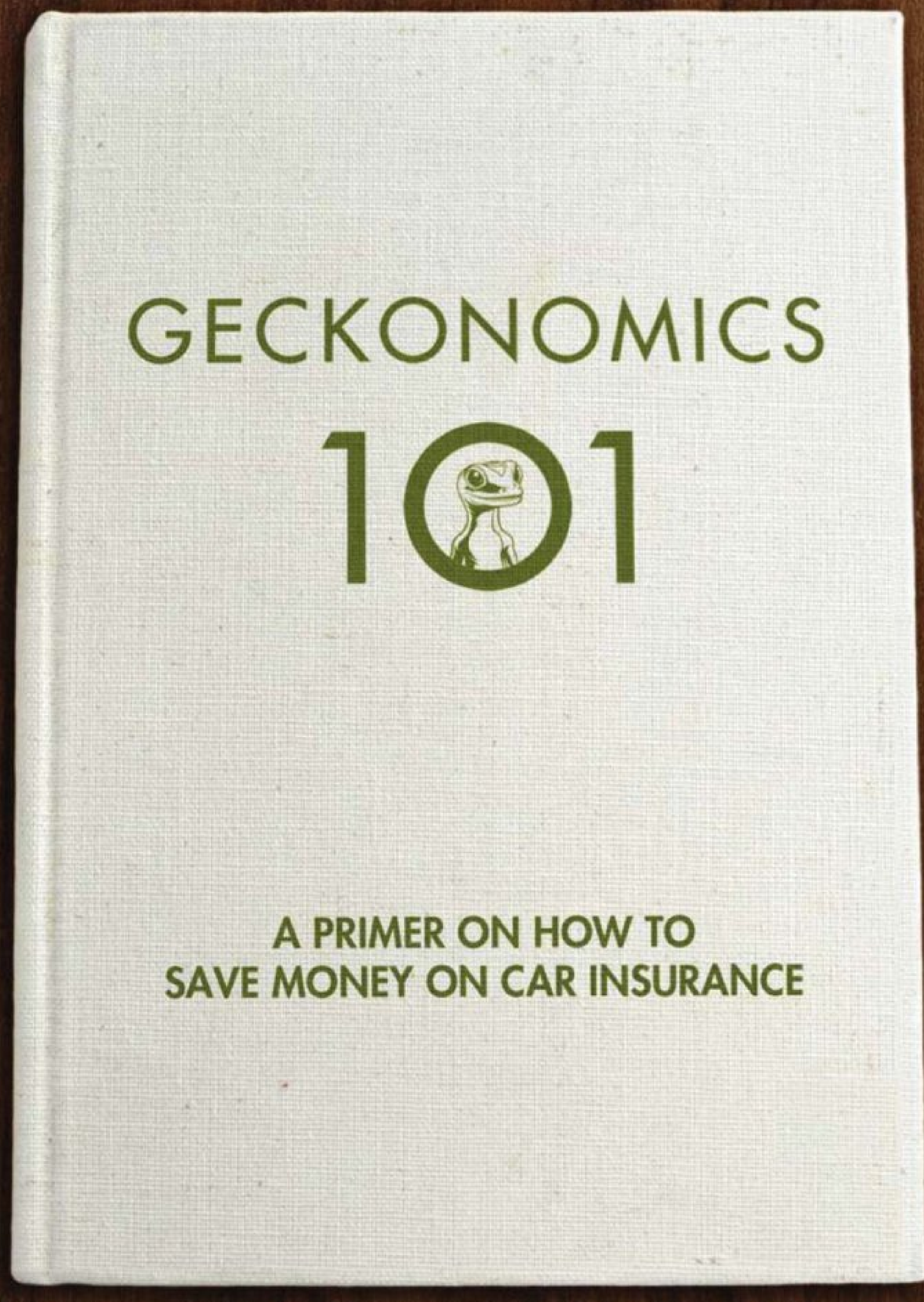
While Heidrick doesn't allow assessment data to be shared with recruiters, CEO Kevin Kelly says worrying about this potential conflict is "an antiquated notion." Up to 40 percent of all searches involve internal candidates, he points out, with extensive assessment going on. Having helped rebrand Heidrick as "a global leadership advisory" firm, he hopes to build on Miles' work: "What he's doing is the future of the industry." Indeed, Heidrick's overall revenue dropped 36 percent last year, to $396 million, but its leadership-consulting services grew 11 percent, to $26 million.

Competitors such as Spencer Stuart grab more headlines for handling top CEO searches, while Korn/Ferry has a larger leadership-consulting practice. Ana Dutra, CEO of Korn/Ferry's consulting practice, refused to be interviewed for what spokeswoman Mary Beth Barron described in an e-mail as "an article about a competitor less than half our size." Miles says simply that Heidrick gives him the resources, reputation, and relationships he needs: "It's an incredible brand."

One reason Miles may be in demand is that he seems to keep his ego in check, and he seeks advice from other experts. As Marshall Goldsmith told him: "The biggest mistake people make at your age is thinking you're a guru when you're not." **B**

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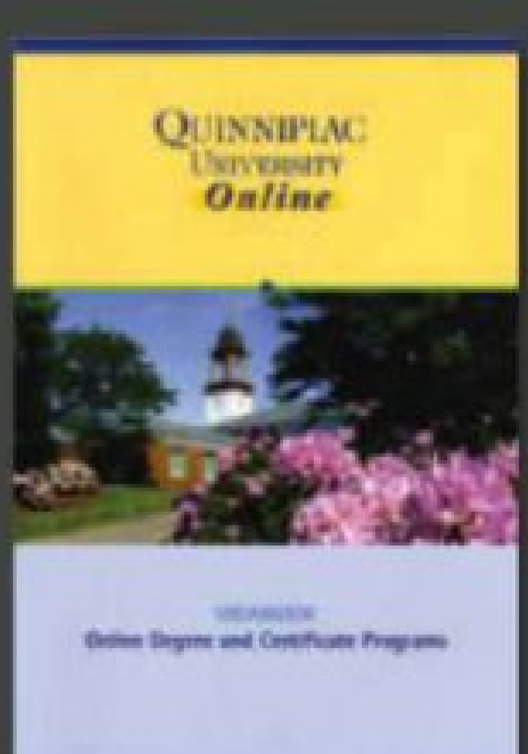


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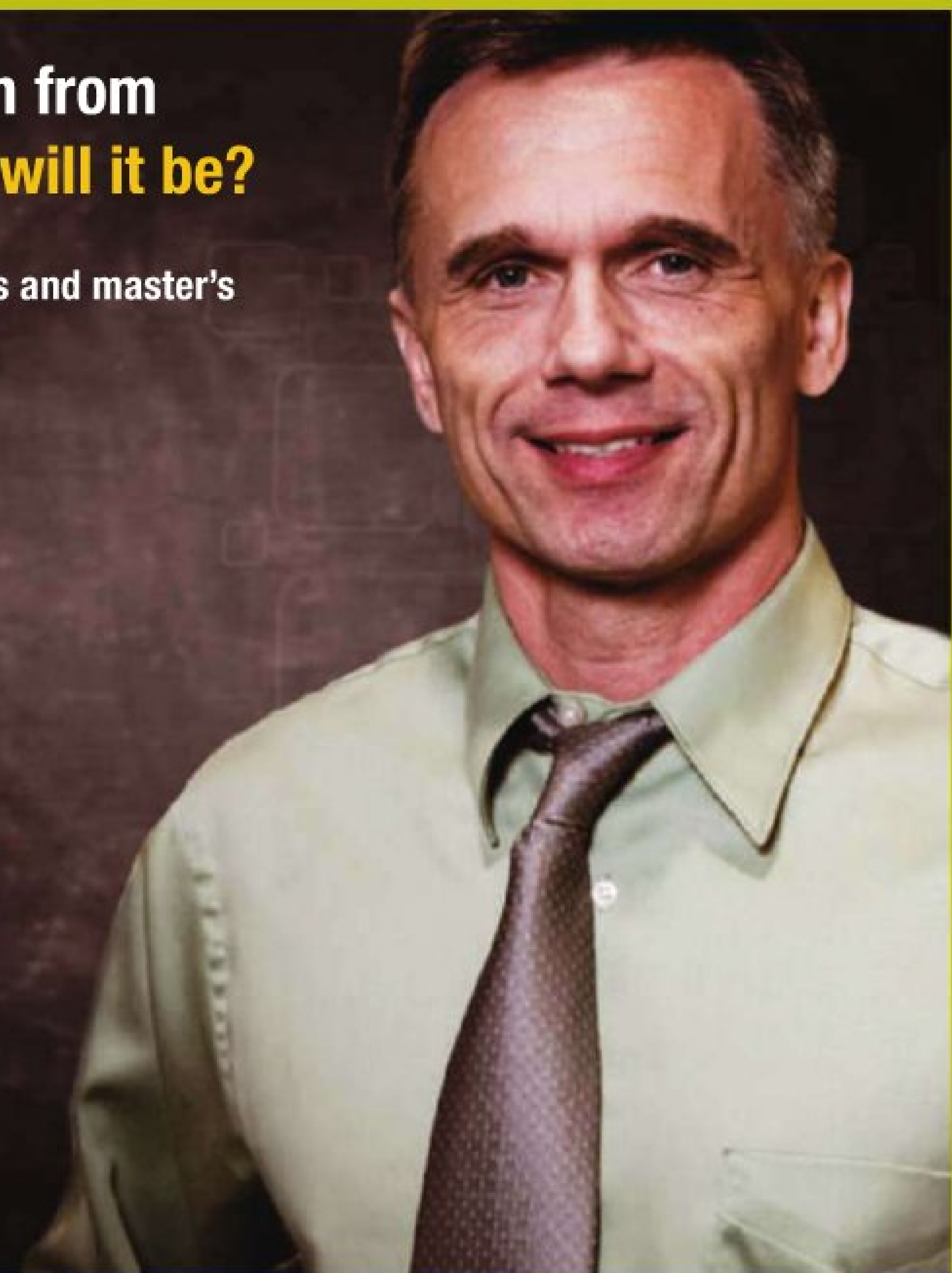
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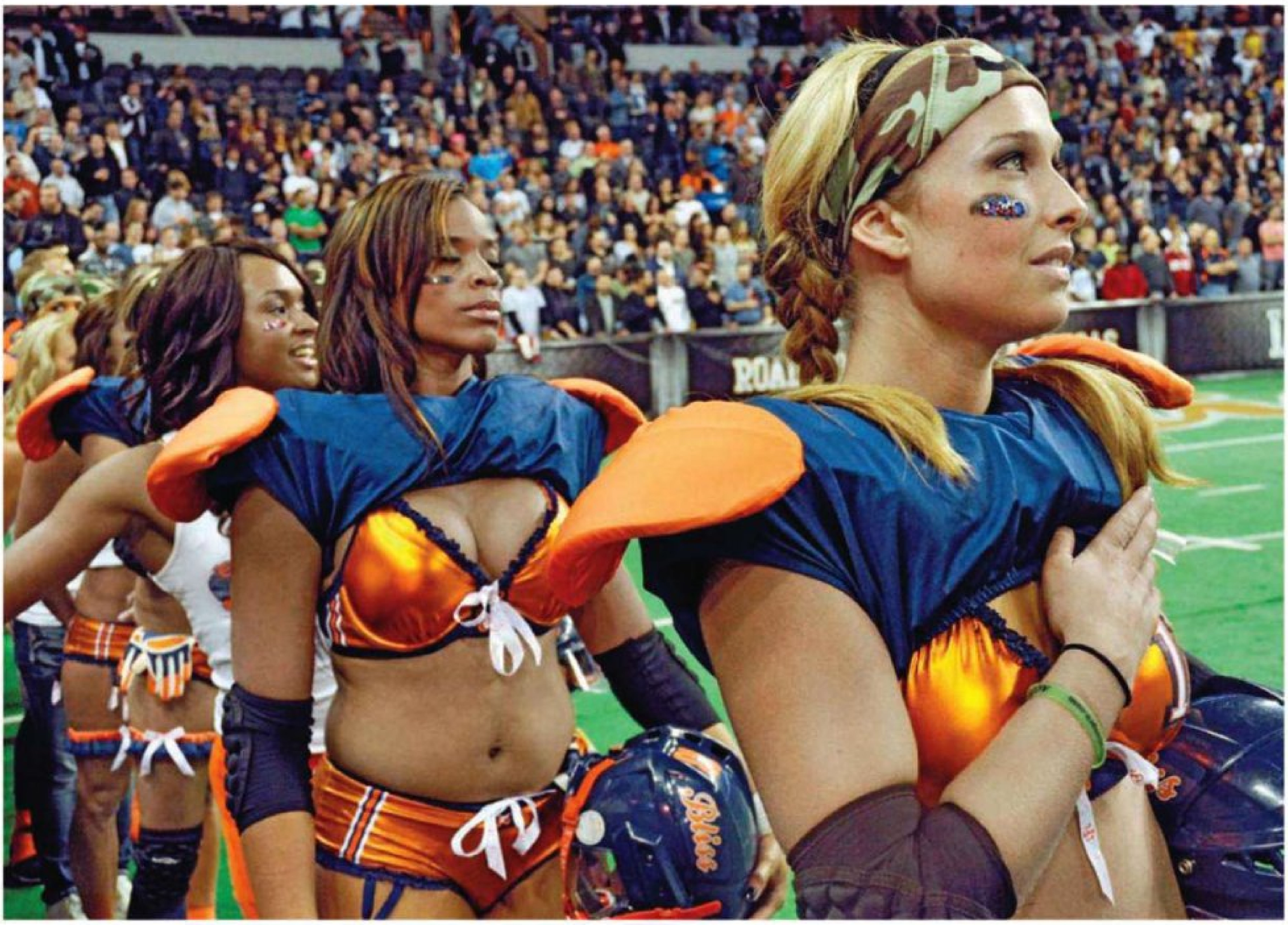
The battle for the living room is on ... Page 96

The Cable Cabal & Nike & Clueless Bankers

Etc.



Picture this jacket on an aging rich dude Page 94



The New Skins Game

The Lingerie Football League is a rarity in sports—a women's professional league that's actually growing. *By Paul Wachter*

Photographs by Andreanna Seymore

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Etc. Lingerie Football League



LFL games draw a few thousand fans, with ticket prices ranging from $15 to $85



Players prepare for a game in their locker room

For decades the National Football League has survived all sorts of gimmicky competitors, from an XFL star named He Hate Me to a Canadian Football League franchise in Las Vegas. Until now, however, it hasn't competed against a league in which women wear skimpy uniforms and pads that expose their cleavage. While playing in the NFL takes a rare combination of strength, speed, and coordination, in the Lingerie Football League, says its founder, Mitchell Mortaza, "You have to be athletic, confident, and beautiful."

Not necessarily in that order. The 10 teams in the LFL play a four-game regular season, from August to February, that concludes with the Lingerie Bowl, aired on Pay-per-view during half-time of the Super Bowl. With players clad in youth-league-size shoulder pads, lightweight helmets, and knee pads, lingerie football is no pillow fight. LFL games are seven-on-seven contests waged on a 50-yard field. No punts or field goals are allowed, and contracts stipulate that players must cope with the possibility of "accidental" nudity. It's a risk many are willing to take. Says Veronica Moor, quarterback of the Orlando Fantasy: "I'd wear a tutu if it meant I got to play football."

Playing a sport in uniforms resembling underwear takes some getting used to. So does tackling. Brittany Tegeler, a 23-year-old former University of Connecticut soccer star, has already suffered a shoulder injury and concussion in her first season with the Baltimore Charm. "The contact was the biggest transition from soccer," says Tegeler. Yet during the starting lineup announcement for a recent game, she appeared healed. Beneath dimmed lights and artificial smoke, Tegeler dropped to the turf and performed a move known as "the reverse worm" while thousands of fans cheered.

Such theatrics were what Mortaza, 37, had in mind when he began the Lingerie Bowl in 2004. While attending the previous year's Super Bowl in San Diego, he had an epiphany. As fans deserted the stands before Shania Twain's half-time performance, he thought some people might prefer a raunchier option. He quit his day job at an Internet services provider and used his savings to launch the Lingerie Bowl. Although he recruited model Angie Everhart to play and Hall of Famers Lawrence Taylor and Eric Dickerson to coach, most of the publicity came from outraged women's groups. Mortaza leveraged all that negative buzz into viewership, and millions paid $19.95 to watch the Lingerie Bowl on Pay-per-view. He decided to make it an annual event.

"I'd wear a tutu if it meant I got to play football," says Orlando's quarterback



LFL owner Mitchell Mortaza

There have been snags along the way. Before the game's 2004 debut, its main sponsor, Dodge, pulled out and was replaced at the last minute by PartyPoker.com. The 2009 Lingerie Bowl was canceled because of a conflict with the owner of the event's venue over clothing—too much of it. "We ran into conflicts with the Lingerie Football League wanting more areas of our resort restricted to 'clothing-required' than we could accommodate," explains Angye Fox, a spokeswoman for Land O'Lakes (Fla.)-based Caliente Club & Resorts, a nudist outfit.

The clothing issue remains controversial. The LFL "is a setback to both sports and society," says Michael A. Messner, professor of gender studies at the University of Southern California. Says Mary Jo Kane, director of the University of Minnesota's Tucker Center for Research on Girls & Women in Sport: "What they're doing is selling sex."

Mortaza believes that may be the only way for what disturbingly, recent history backs him up. Despite the rising popularity of the sport, the Women's United Soccer Assn. disbanded in 2003. The Women's National Basketball Assn., while heavily subsidized by the National Basketball Assn., has seen several franchises fold. In recent years, prize money

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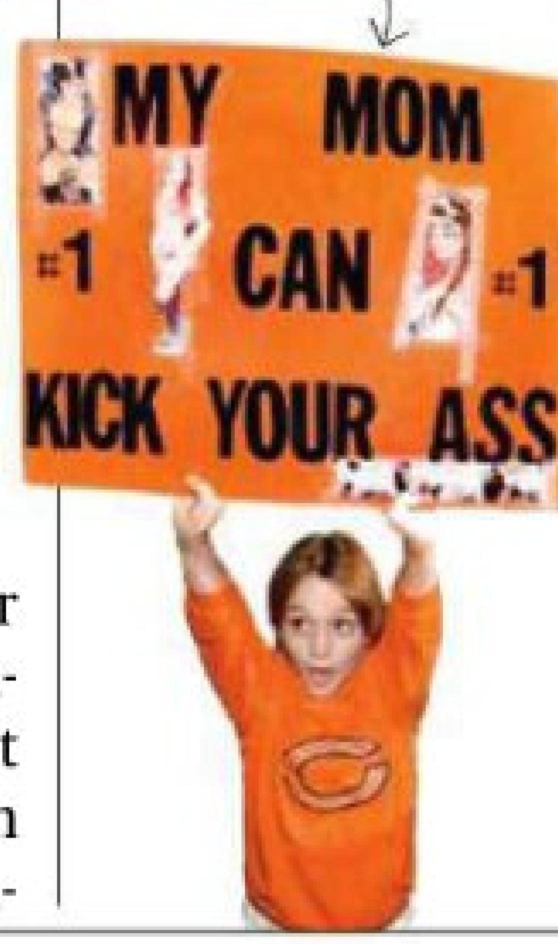


Despite minimal protection, LFL players aren't shy about contact

for the Ladies Professional Golf Assn.—which never equaled that of the men's tour—has fallen. Even professional women's beach volleyball, whose uniforms are skimpier than the LFL's, folded in 1998 before being restarted in 2001. Women's tennis has come close to rivaling the popularity of its male equivalent, but sex appeal is part of the package. Anna Kournikova, once among tennis's highest endorsement earners, never won a Women's Tennis Assn. pro singles tournament. Currently, Maria Sharapova tops the earners' list even though she hasn't won a Grand Slam since 2008. As Serena Williams said at a Wimbledon press conference in 2009: "Sex sells." Perhaps that's why the LFL is growing.

After the inaugural Lingerie Bowl, Mortaza had his second epiphany: Lingerie football was bigger than just one annual game. He envisioned a national sports league featuring serious athletes—albeit mostly naked—in major markets stretching from Los Angeles to Miami. He began recruiting coaches from semipro leagues and advertised tryouts on local radio stations. Players are paid anywhere from a couple hundred to a couple thousand dollars per game, depending on the number of tickets—which range from $15 to $85—sold.

The league attracts fans of all ages



In 2009, Mortaza launched the LFL with 10 teams and a television deal with MTV2, and he says the league made a profit its first year. While two teams, the New York Majesty and the Denver Dream, folded because Mortaza couldn't secure favorable stadium deals, he found replacements for the 2010 season. The new teams, the Baltimore Charm and Orlando Fantasy, squared off on a cold November evening inside Baltimore's 1st Mariner Arena—and both showed signs of inexperience. On the very first play, the Charm's quarterback threw the ball into the dirt five yards in front of her intended receiver. A few snaps later, however, she delivered a touchdown strike. The Fantasy equaled the score on their opening drive, despite seeing their starting running back limp off the field after a hard tackle. In the end, the Charm pulled away and won the game 42-19.

"I thought I was one in a million being pretty and athletic," says Tiffani Hardin, a junior at the University of Central Florida and middle linebacker for the vanquished Fantasy. "The first time I played with the LFL, I got knocked on my ass. You can say what you want about the uniforms, but these women are real athletes and they're fierce." As she left the field, an announcer encouraged fans to linger and get autographs from their favorite players.

Mortaza claims that the 2010 season, which culminates on Super Bowl Sunday in Las Vegas, is going even better than expected. "We're 260 percent more profitable so far this season than at the same point last year," he says. Already, he's thinking beyond the U.S. market. The LFL has held a game in Mexico City and plans another in Tokyo. "We're really big in Australia," says Mortaza. Meanwhile, the Charm-Fantasy game earned a two-sentence write-up in *The Baltimore Sun*. At least it was in the sports section. **B**

A League of Its Own

A failing precedent exists for leagues that dare to threaten the NFL. Then again, nobody has tried to replace padded, sweaty men with scantily clad women. —*Patrick Cain*











World Football League (1974-1975)	U.S. Football League (1983-1985)	World League of American Football (1991-1992)	Canadian Football League: U.S. expansion (1993-1995)	XFL (2001-2001)
Gary Davidson successfully founded the American Basketball Assn. and the World Hockey Assn. Yet his WFL ran up an estimated $20 million in debt and folded before the end of its second year.	While the USFL introduced the two-point conversion (and Reggie White to the pros), it was undermined by an owner, Donald Trump, who insisted on scheduling the season to overlap with the NFL's.	Started by the NFL to promote football abroad, the WLAF led to the NFL Europe. Its final incarnation, NFL Europa, was disbanded in 2007. By then the league was losing $30 million a year.	After the debut of its Sacramento team in 1993, the CFL created franchises in Las Vegas, Baltimore, and elsewhere. By 1995, however, all the U.S. teams had folded or relocated north.	Founded by World Wrestling Entertainment Chairman Vince McMahon and NBC, the XFL held a championship game that was, at the time, the lowest-watched major network broadcast in prime time.

LFL: PHOTOGRAPHS BY ANDREANNA SEYMORE FOR BLOOMBERG BUSINESSWEEK; OPPOSITE PAGE: MORTAZA: NANCY OSTERTAG/GETTY IMAGES; THIS PAGE, TRUMP: RAY TAMARRA/FILMMAGIC; CANADIAN: BRAD MANGIN/SPORTS ILLUSTRATED/GETTY IMAGES; "HE HATE ME": TODD WARSHAW/ALLSPORT/GETTY IMAGES

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The French-born Italian mogul and budding fashion guru in his new Manhattan boutique



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The Emperor's New Clothes

Mogul and international playboy Jean Pigozzi is trying to create a fashion empire. *By Joe Pompeo*

One recent afternoon, Jean "Johnny" Pigozzi, the globe-trotting art collector and entrepreneur, greeted a young couple as they walked into LimoLand, his new clothing boutique in Manhattan's Meatpacking District. "Hello, hello," he said brightly in his deep, somewhat incomprehensible pan-European accent. One member of the duo was wearing a neon green backpack reminiscent of the glaring colors that define Pigozzi's fashions. The satchel caught the French-born Italian mogul's attention—but not for the right reason. As the pair shuffled past him, Pigozzi lowered his voice to a whisper. "These kids will not buy anything," he said. "I know the people who buy. If they have a backpack, they don't buy."

"I'm really interested in R-O-Ms," Pigozzi says. "Rich. Old. Men."

Pigozzi goes to extreme lengths to know just who buys. He keeps a close eye on LimoLand—his first boutique dedicated exclusively to his clothing line of the same name—even when he's not there. Four surveillance cameras positioned around the 750-square-foot store allow Pigozzi, 58, to observe the business from, alternatively, his villa in the South of France, his spread in Panama, and his apartments in London, Paris, Geneva, and Manhattan. Although he's been in the fashion business only a few years, he's already profiled his core customer. "Old men? Very good!" he says. "A 45-year-old with a bald spot? *Excellent*." Pigozzi has created his unsubtly titled collection with a specific buyer in mind. "I'm really interested in R-O-Ms," he confesses. "Rich. Old. Men."

This is hardly surprising considering that Pigozzi, the Harvard-educated heir to France's Simca automobile fortune, is a friend to ROMs the world over. He has collected a cohort—David Geffen, Barry Diller,

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and Bono among them—through his various turns as a businessman, venture capitalist, philanthropist, photographer, patron of the arts, and, perhaps most notably, international playboy. "I don't think there's a billionaire that Johnny doesn't know," says movie director Brett Ratner. "He's at the center of the universe." When *Vanity Fair* published its 2008 "New Establishment" list of the most influential people in the world, it ran a chart explaining how each was connected to Pigozzi.

However, if you ask Pigozzi for his avocation, he says he's simply "curious." Curious enough to have dabbled professionally in film and hedge funds; to have amassed the world's largest known private collection of contemporary African art; and to have founded a marine and forest research laboratory on a small Panamanian island that he bought for the sake of land conservation. "Every five years, I decide to learn something new," he explains. It was in this spirit that he decided to design fluorescent streetwear for aging rich dudes.

Pigozzi, who has a a hulking, 6-foot-4-inch frame and a penchant for loud palettes, started LimoLand in 2007 out of sartorial frustration with the muted hues and lean sizes dominating designer menswear. He wanted to create a brand for wealthy Europhiles who like their wardrobe casual and loose—and who, since they don't have to impress anyone, aren't afraid to add a little color. "There are a lot of people who don't want to dress in black and don't have to wear suits," says Pigozzi. He started drawing designs by hand, hired a consultant for "the technical stuff," and invested about $1.5 million of his personal fortune to launch the line, which now ranges from a $45 T-shirt to a $595 weekend tote, in elite boutiques in Tokyo, Paris, and New York.

Sales at the LimoLand shop so far have been promising, Pigozzi says, which bodes well for his plot to build an international luxury brand. In "three or four years," he claims, clothing will be only 30 percent of the business. The other 70 percent will be some combination of restaurants, liquor, hotels, travel resorts, furniture, housewares, and maybe yachts. (His own, a converted research vessel, was named the world's 58th largest in 2006, according to *Power & Motoryacht* magazine.) Pigozzi's "ultimate goal" is to bring LimoLand to Moscow and mainland China. "I have big dreams," he says. "I want to make a lot of money off of this."

It doesn't hurt to have a Rolodex full of famous friends. LimoLand's celebrity clientele includes Ratner, pop star Usher, hotelier André Balazs, orange-clogged chef Mario Batali, and Mick Jagger. "It will not be surprising to me when it's a success, because he's a very clever guy," says billionaire investor Ronald Perelman, who's known Pigozzi for 20 years. "He's targeted in his thinking. I think he'll come out with products that people will want to have."

Most pieces are outrageously bright and, perhaps as a result, mogul-chic. In his boutique they are seamlessly displayed against an exposed-brick wall adorned with a portrait of the gangsta rapper Birdman by artist Tom Sanford. The trick with each piece, Pigozzi says, is in the details. LimoLand's Navy blue hoodie sweatshirt—"the blazer of the 21st century!" he says—has a rainbow pattern in the zipper's teeth. "Johnny's attention to detail—and his sense of humor and color and his philosophy about his collection—is really unique," says Madeline Weeks, *GQ* magazine's fashion director. "Cashmere companies won't do a bright pink or purple sweater for a man. He likes to stand out."

Within the next year, Pigozzi plans to open another LimoLand in Manhattan and possibly one in Los Angeles. He's also trying to get his clothing into luxury department stores such as Bloomingdale's, Barneys New York, Bergdorf Goodman, and Nordstrom. Meanwhile, Pigozzi is promoting his other projects. He recently published a book of photography about his world travels, and an accompanying exhibition is currently showing at Manhattan's Gagosian Gallery. His next stop is Miami for the annual Art Basel/Miami Beach fair, where he plans to peruse African and Japanese work.

At the end of the day, Pigozzi says, he doesn't want to be bored. "I hope that in the next 30 or more years I have to live, I will be doing everything that I don't [yet] know I will be doing. That's what makes it fun." Just like designing contrast color sweatpants for rich old men. B

"He's targeted in his thinking," says Ronald Perelman of Pigozzi



LimoLand's Geometric Print Hoodie sells for $145



The store features a mural of rapper Birdman



Pigozzi's travel cases are priced at $125



The Mary Poppins-esque Kway Trench Coat retails for $225

PIGOZZI, STORE: PHOTOGRAPHS BY ADAM KRAUSE FOR BLOOMBERG BUSINESSWEEK

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Etc. Hands On



The Logitech Revue, which operates Google TV, costs $299

The large, geeky keyboard remote control can be replaced with a $129 smaller version

The new portal to the video universe

Boxed Out

If you can figure out how to use it, the Revue will satisfy your inner TV geek. *By Rich Jaroslovsky*

The Logitech Revue, the new Google TV gadget, should carry a warning label: "Not intended for normal people." It's a set-top box for those who don't mind stumbling over an occasional "page not found" message on their big-screen television or changing channels with a keyboard. Yes, the $299 Revue's remote control is a full-sized wireless keyboard. It does offer a smaller remote for an additional $129. That has a small keyboard, too.

Understand that Google TV isn't itself a device. It's software that provides a single interface to the video universe and locates shows whether they originate with a cable or satellite provider, paid online services such as those from Netflix and Amazon, or free sites such as YouTube. Besides the Revue, Google TV is built into a line of Sony TV models and one of its Blu-ray players. These products are among the growing number of products staking a claim on the future of the living room.

Connecting the Revue is easy: Just plug it into the TV and plug your cable or satellite box into it. It gets trickier when it comes to the 12 steps it takes to configure the Revue, a process that consumes the better part of an hour and requires a good deal of patience.

The idea behind Google TV is a good one. Viewers shouldn't have to care where an episode of *Entourage* comes from. The problem is that the world of video is a wild and woolly place, and Google TV falls short of being able to tame it.

One example: Google TV helped me locate a 2005 episode of *South Park* on Netflix, but when I tried to play it, I received an error message. It took a call to Logitech to learn that I couldn't actually watch the program from the place Google TV brought me; instead I would have to launch Google TV's separate Netflix app. Of course!

By that point, the average viewer might give up and reach for the good old one-hand remote (particularly those unable to figure out the difference between "bookmarks" and "queue" on the user interface). Yet the undaunted few can actually have some fun. I was able to watch shows on the big screen that I otherwise would have had to watch on a computer.

A search for Stephen Colbert yielded not just recent episodes of *The Colbert Report* but also a 2006 profile of him on *60 Minutes*. Look for Hugh Laurie, and you'll not only find a ton of *House* listings but also an Amazon link to his *Jeeves and Wooster* series, and YouTube clips of his turn as the dim-witted prince regent on the old *Black Adder* britcom. Add to that the ability to surf the Web while your television continues to play in a picture-in-picture window, and you'll be in TV-Web geek heaven. That is, only if you're a TV-Web geek. B

The Cable Cabal

A crowd of set-top boxes is jostling for access to HDMI jacks, either to augment the offerings of the Comcasts and DirecTVs, or—eventually—displace them.



Veebeam ($99-$139)

Does one thing and one thing only: streams what you see on your computer to your TV. But does it very well.



Apple TV ($99)

It's simple, it's elegant, it's Apple. Though so far it offers few programming sources outside Steve Jobs' orbit.



TiVo Premiere ($99)

A DVR that replaces your cable box and brings in online content—for $19.99 a month in fees.



D-Link Boxee Box ($219)

The box makes TV social: You can suggest and receive recommendations.



Roku Player($59-$99)

About as simple as you can get, with a growing universe of content. And the most cost-effective, too.

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Inside the Swoosh

Employees sweat it out between meetings at Nike

The most enviable perk that comes with working at Nike's world headquarters in Beaverton, Ore., is that it's easy to schedule your workday around a spin class—or football game or free swim. Unsurprisingly, the campus' 7,000 employees are encouraged to take time out of the workday to work out. There's never downtime at the two employee gyms, the Bo Jackson and Lance Armstrong. (The campus' 17 buildings are all named after Nike-sponsored athletes.) Midday sessions with a personal trainer or tennis coach—all of whom are on staff—are routine, and meetings are regularly moved to hiking trails. Somehow, the job gets done: In 2009, Nike raked in $19.2 billion in revenue, and it remains the biggest sportswear brand in the world. B —*Jessica Flint*



The Oregon campus is located on 178 acres of natural wetlands.



Hiking trails and running paths of varying lengths are located behind the basketball court.

No need to BYOB: Racks of Nike basketballs are provided.

Jocks and sports teams use the court when they're in town. Kobe has been known to shoot hoops here.



After class, employees hit locker rooms with steam rooms, saunas, and hot tubs.



This season's Nike gear is more than 40 percent off at the two on-site stores.



The pool overlooks practice soccer fields. Beach volleyball courts and an outdoor track are nearby.

The Perks

1. Basketball Court
Employees play pickup games on the Bo Jackson gym's full-size court. They also use the floor to test out the latest gear.

2. Sports Bar
The Boston Deli pub—one of five campus restaurants—always has a game on TV. During major sporting events, screens are set up in the cafeterias so employees can watch while they eat.

3. Gyms
Group workout classes, such as spinning, yoga, and Pilates, take place at the Lance Armstrong gym, which has an array of free weights and cardio machines.

4. Employee Stores
The campus has two discount shops: one for employees and one for their families, Nike endorsers, or guests who score a pass.

5. Pool
The Lance's 11-lane Olympic-size pool is used for lap swimming and training classes. It has starting blocks and a timing clock.

6. Climbing Wall
A 44-foot indoor climbing wall in the Lance has top-rope and bouldering routes. (It also has a balancing rope for show-offs.) Gear is available at the gym's front desk.

More Perks: Jeans-and-sneakers dress code ▸ Hair and nail salon ▸ One-day dry cleaning service ▸ Nutrition and wellness classes ▸ Two floral and gift stores

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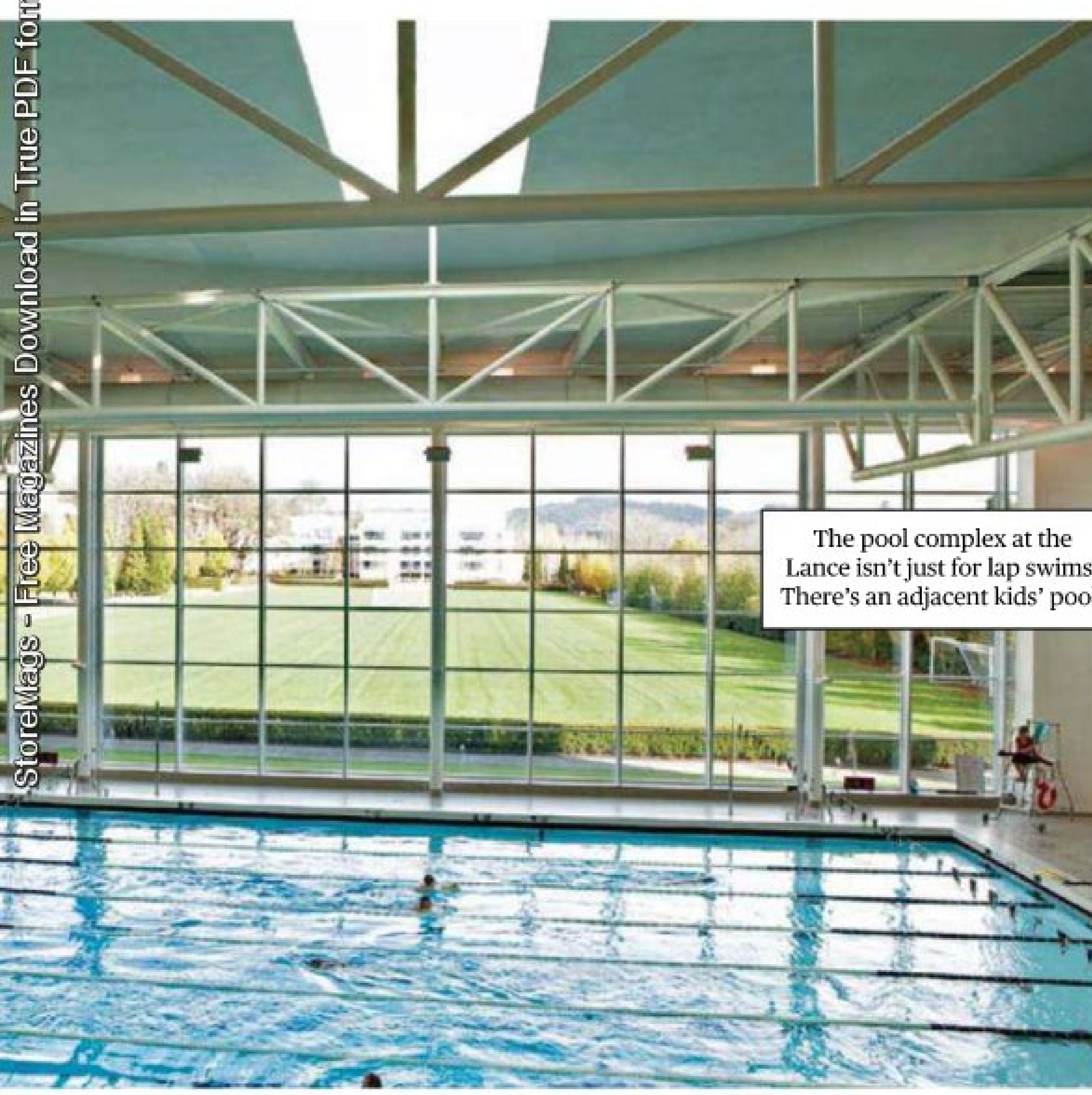
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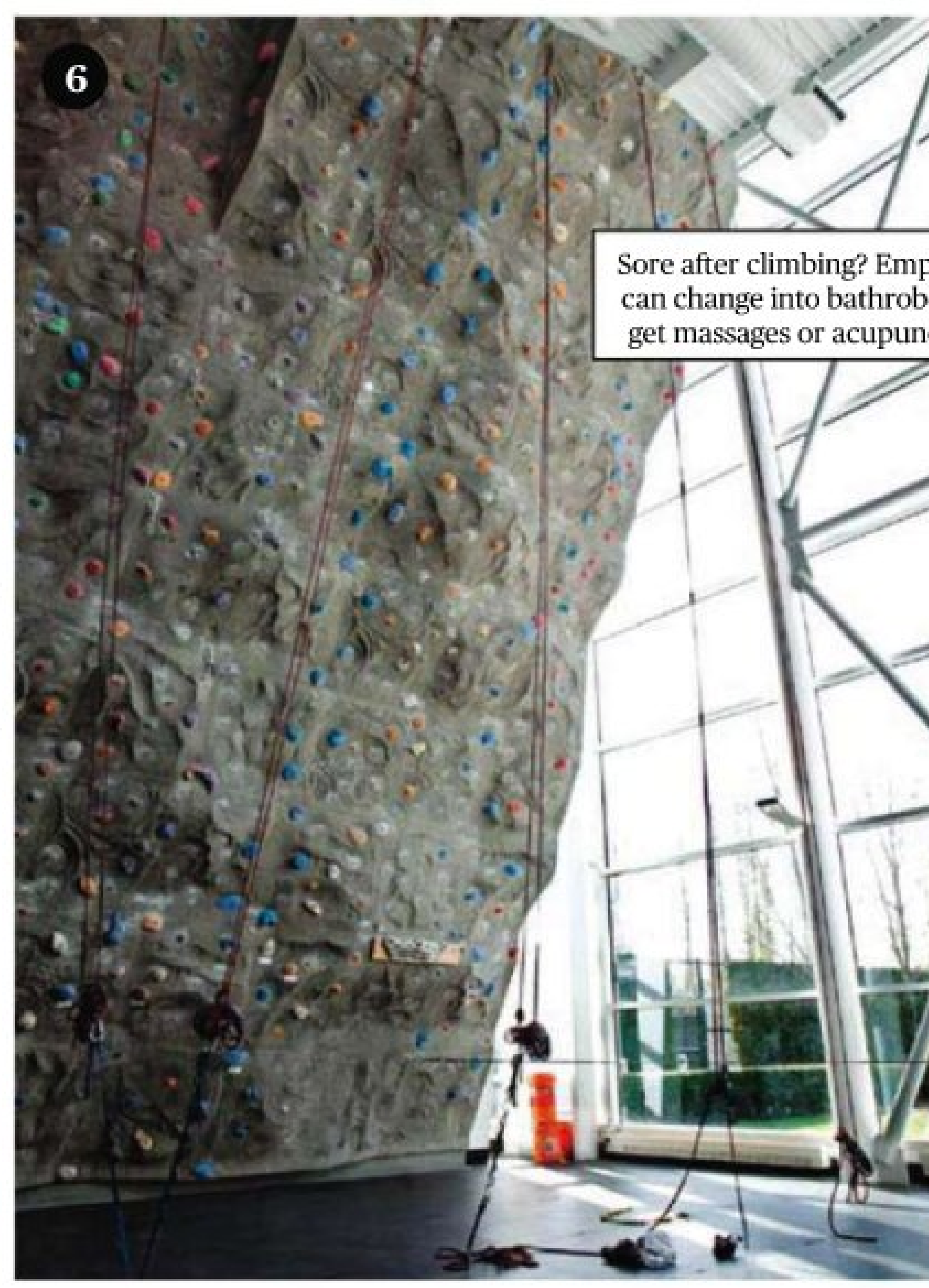


Football helmets from pro and college teams with Nike contracts.

Hall of Fame-quality sports memorabilia is on display all over campus.



The pool complex at the Lance isn't just for lap swims: There's an adjacent kids' pool.



Sore after climbing? Employees can change into bathrobes and get massages or acupuncture.

▶ Summer hours ▶ Two copy shops ▶ Shoe recycling bins ▶ Bike storage ▶ Two state-of-the-art, LEED-certified kids' centers ▶ Shuttle buses between campus buildings

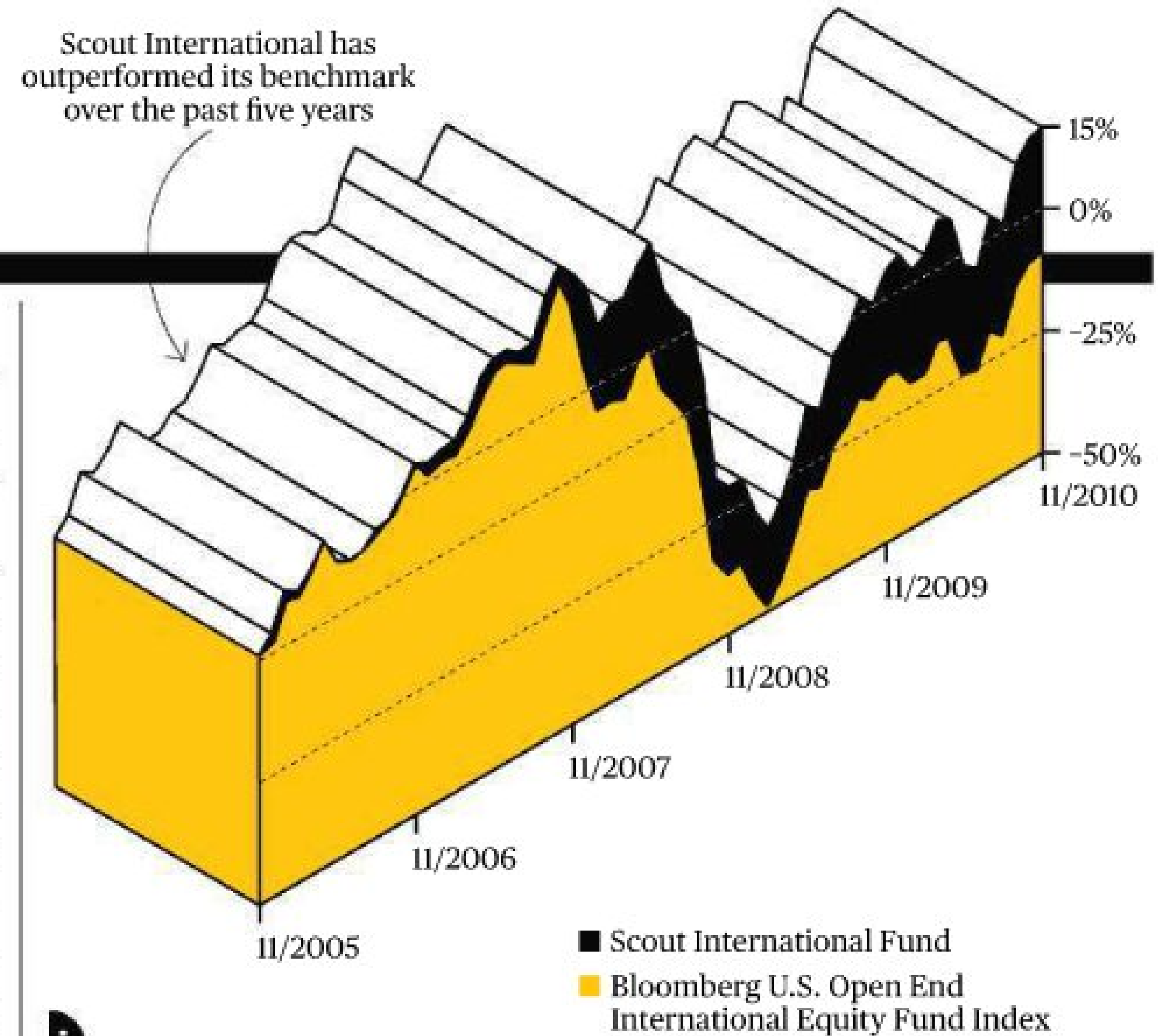
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The Waiting Is the Hardest Part



Scout International Fund's James Moffett buys and holds industry-leading, growth-oriented companies with little debt

What distinguishes us from most money managers is that we're long-term investors with about a five-year time horizon for most of the stocks we own. We focus on a few major variables. One is the long-term outlook for the country where our companies have operations and another is the long-term outlook for the companies themselves. Tied into that is a focus on quality, strong balance sheets, low debt, and a growth orientation. We are looking for industry-leading, dominant companies that control their destiny and have good management and good profitability to show for it. We don't want to be in countries where you can't quantify the risks, such as smaller emerging markets, and countries such as Russia or China with strong government control of business and capital markets. B

—As told to Lewis Braham

THE STATS DATA: BLOOMBERG

James L. Moffett, chief international equity strategist for Scout Investment Advisors, oversees about $7 billion. His Scout International Fund has beaten 90 percent of its foreign-stock fund peers in the past decade.

Moffett on his picks...



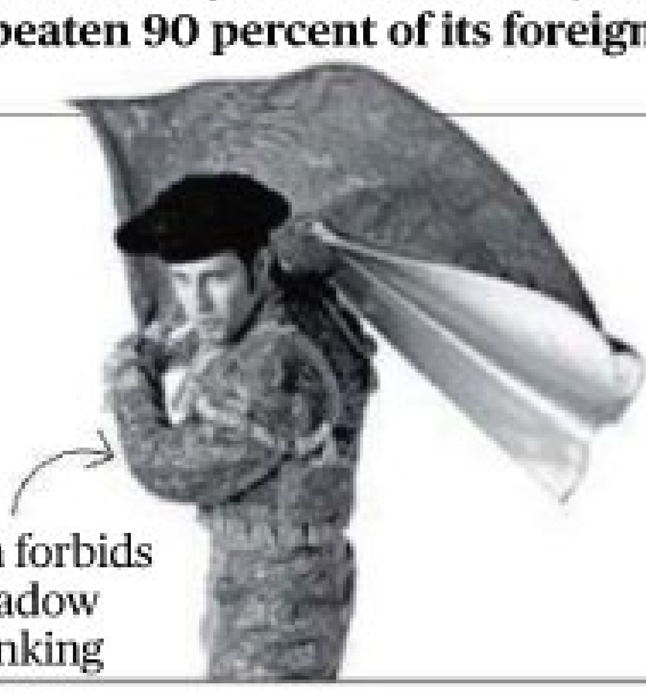
1. BMW

The company has a new series of cars that we think should do well. The consensus is that this year BMW will earn €4.13 a share and €5.11 next year. That means it is selling at 12½ times this year's earnings and 10 times next year's earnings, which makes it very attractive. The company has more debt than we normally like, but it's well capitalized and we think its operating margins are in good shape. The company is 44 percent family-owned. We like the large insider ownership.



2. Fresenius Medical Care

This German company is the world leader in kidney dialysis equipment, making 90 percent of the equipment sold in the U.S. It has substantial family ownership, and that is a stabilizing factor. Its earnings growth rate is steady—about 10 percent to 12 percent a year. So we are paying a premium—19 times 2010 earnings and 18 times 2011's. But that's for a stable return. Debt to equity at 65 percent is probably high, but a stable business can tolerate that more than an auto company.



Spain forbids shadow banking

3. BBVA

It's the second-largest Spanish bank, but 55 percent of BBVA's profits come from outside the country. Although Spain's unemployment rate is twice ours—and its economic bubble is bigger—this bank's making money and is solvent because Spain's regulators wouldn't let it do some of the stupid things we did. They made BBVA keep a higher level of reserves. They wouldn't allow shadow banking. It trades at a low 7.4 times this year's earnings and 6.8 times next year's.



4. Fanuc

Japanese robotics company Fanuc is the real poster child for a dominant global business. It has a 60 percent market share in China's factory automation business. We don't think of China using robotic processes—it is full of cheap labor—but as it works its way up the manufacturing chain, China will become more capital intensive with more sophisticated manufacturing. Fanuc has an ironclad balance sheet, zero debt, and we see the underlying earnings growth rate in the 10 percent to 12 percent area.

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As the oeuvre of crisis literature has shown, the meltdown was a team effort



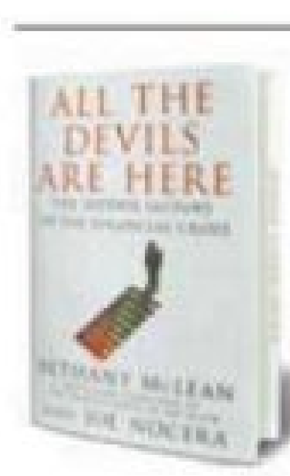
ILLUSTRATION BY ANDREW RAE

A Crisis of Confluence

The meltdown's secret? Smart people do dumb things. *By Ian McGugan*

One of the great mysteries of the financial crisis is that more than two years and dozens of books after its onset, we're still trying to figure out exactly who pulled off the heist. In *All the Devils Are Here*, Bethany McLean and Joe Nocera attempt to create a financial whodunit and take the latest stab at apportioning responsibility. The result–a Hieronymous Bosch painting of Wall Street bankers, insurance conglomerates, and Washington insiders–is hardly uncharted territory. Yet the authors distinguish themselves through clever sleuthing. Sure, many investment bankers, credit-rating agencies, and regulators were malignant in one way or another, but just as many were simply clueless. The authors' grand conclusion is rather simple: Bright people can do some pretty stupid things.

Take investment bankers. They brewed the intoxicants that spurred the mortgage frenzy and formulated mad-scientist concoctions–like the infamous "synthetic CDOs"–that were essentially casino bets on the housing market. Somewhat inexplicably, Wall Street also bought its own poison in the form of housing-related debt, derivatives, and options. American International Group, Bear Stearns, Lehman Brothers, and Merrill Lynch died–or set themselves up for near-death experiences–by drinking their own potions. Are these people *really* evil geniuses? Schlubs is more like it. As one risk manager at Merrill told the authors, "We fell for our own scam."



All the Devils Are Here: The Hidden History of the Financial Crisis
By Bethany McLean and Joe Nocera
Portfolio; 400pp, $32.95

Rating agencies such as Standard & Poor's, Moody's Investors Service, and Fitch were intended to be one of the system's primary monitors of these companies' creditworthiness. Yet, the authors write, they had failed to issue a single warning about Enron, Tyco, or WorldCom before those companies started to blow up in 2001. That dismal experience should have hammered the credibility of ratings and raters. Yet the rating business thrived for the simple reason, McLean and Nocera attest, that both financial institutions and government needed an apparently independent body to put a seal of approval on corporate debt. As one former analyst says, "Enron taught [the raters] how small the consequences of a bad reputation were."

They took the lesson to heart. Throughout the housing bubble, the agencies stuck triple-A ratings on huge swaths of mortgage-backed securities without bothering to ask what might happen if credit were to slow down or house prices were to fall.

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In a better world, regulators would have clamped down on Wall Street and the rating agencies and forced them to correct their previous mistakes. However, as McLean and Nocera explain, regulators had little muscle in an age when both Democrats and Republicans believed the market should regulate itself.

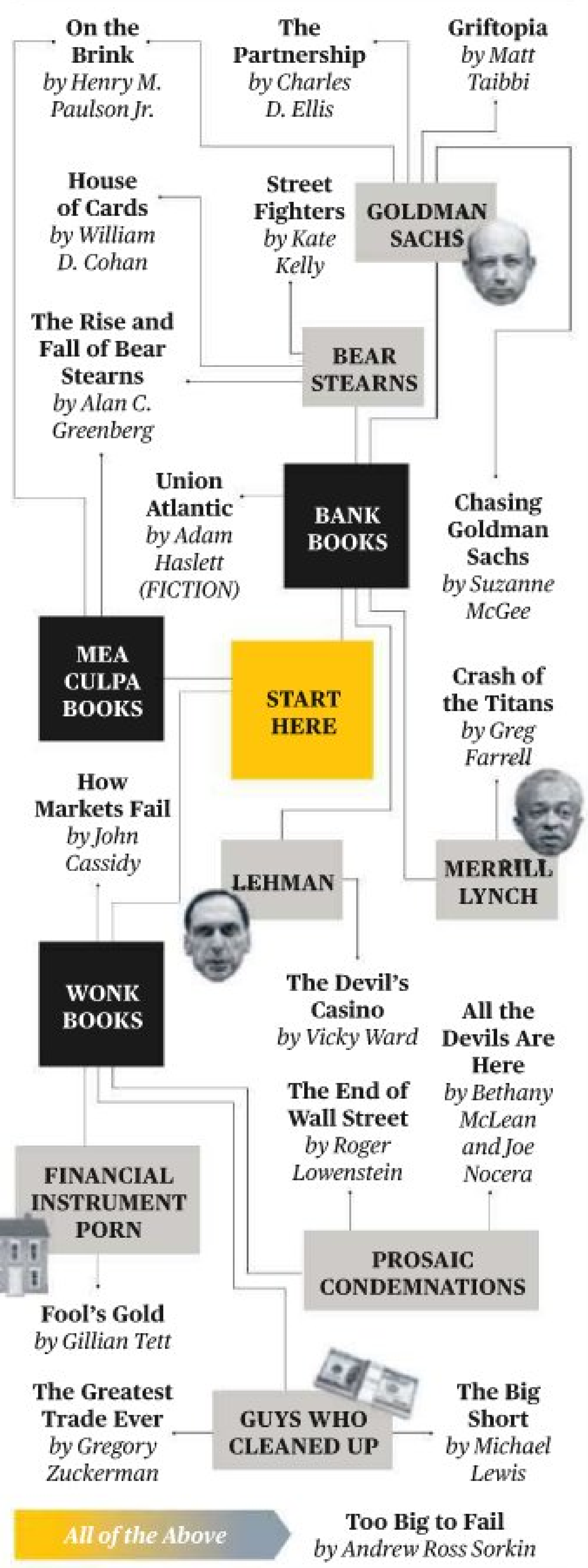
The authors tell the tale of Brooksley Born, head of the Commodities Futures Trading Commission, who tried to police financial derivatives during the Clinton Administration. For her efforts she got a bureaucratic mauling from free-market apostles Lawrence Summers and Robert Rubin, both of whom were adamant that derivatives didn't need to be supervised. Many regulators, however, weren't as well-intentioned as Born. Some tried to expand their empires by granting institutions freedom from persnickety restrictions such as state laws intended to end predatory lending. Even after 25 states tried to crack down on mortgage abuses and the FBI warned of the dangers, federal regulators remained blithely unconcerned.

Dicey firms thrived in this environment. Ameriquest, a mortgage originator that inflated appraisals, encouraged customers to lie about their incomes and misled clients about fees. At Ameriquest, the authors write, twentysomething loan officers fueled by diets of coke and meth worked 14-hour days and made $20,000 or more a month if they survived the nonstop pressure from above. "Think *Glengarry Glen Ross*," one of those former loan officers tells the authors.

Eventually, it all had to come tumbling down. After brilliantly detailing the blunders of a multitude of institutions and individuals, McLean and Nocera come to a tame conclusion. "Much of what took place during the crisis was immoral, unjust, craven, delusional behavior," they write, "but it wasn't criminal." Just criminally stupid. Ⓑ

The Financial Crisis Book Map

With *All the Devils Are Here*, the financial crisis subgenre appears to be mercifully approaching its end. —*Devin Leonard*



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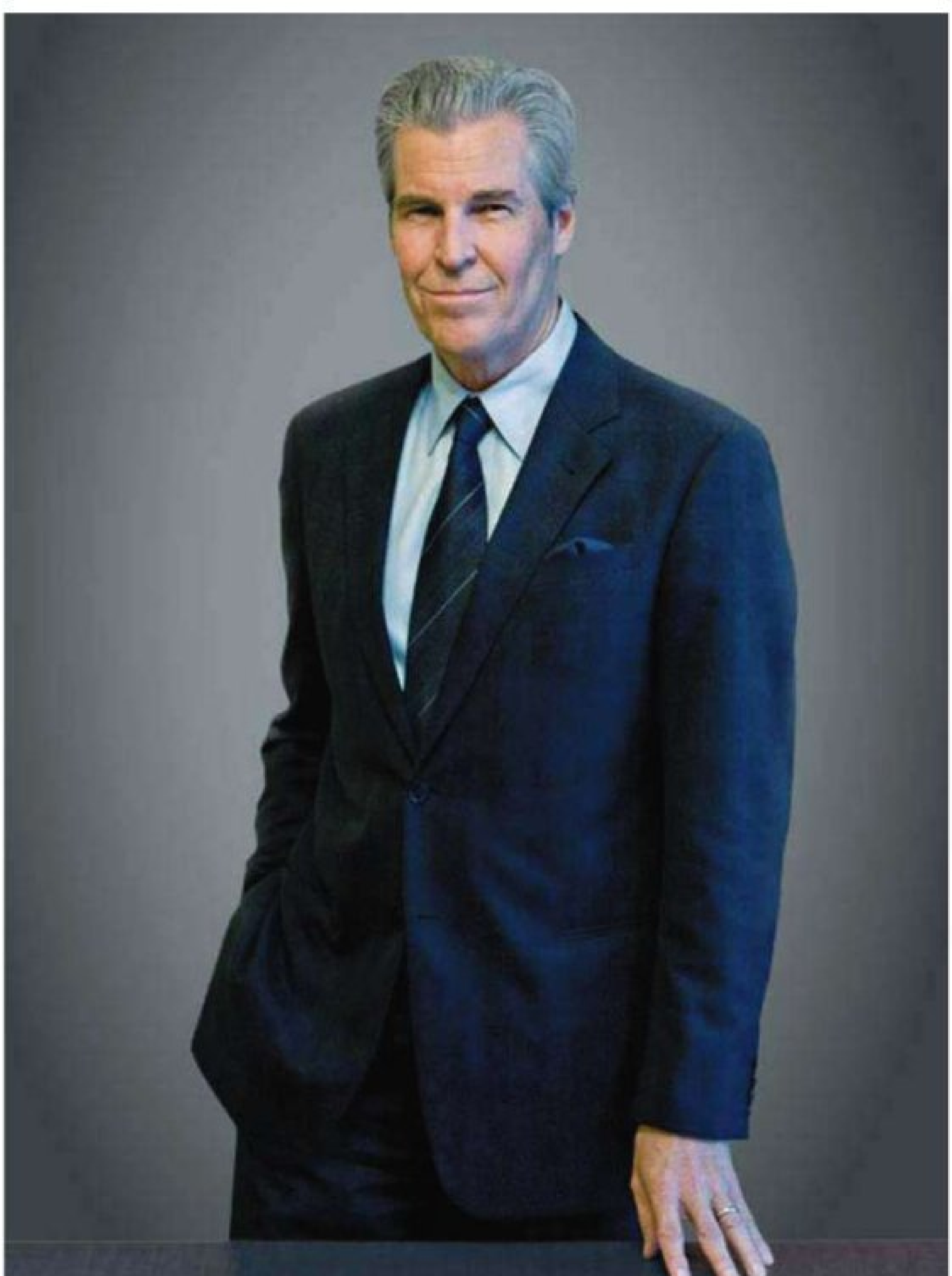
StoreMags

Etc. Hard Choices

Terry Lundgren

"Since we weren't a national brand, I couldn't even advertise during the Macy's Thanksgiving Day Parade"

The Macy's CEO on expanding the company by uniting century-old department stores under one name



In 2004, I became the CEO of Federated Department Stores. That's what we were called then because that's what we were: a company made up of individual department stores in regional markets. We were printing 16 different bags, running 16 different catalogs, and had buyers who bought only for their area of the country. And we could only run local TV ads, so we'd create 16 different commercials. Since we weren't a national brand, I couldn't even advertise during the Macy's Thanksgiving Day Parade.

I thought the big play was to take advantage of Macy's association with the parade and create one cohesive brand. In 2005, I decided to test the idea, and we began hyphenating our store names. In Atlanta we were called Rich's-Macy's or in Miami we were Burdines-Macy's. There was a lot of pushback. We were taking away names that were 100, 130, even 140 years old, and there was a family behind the name in almost every instance.

We had to fight to make everything just Macy's. One tough one was Meier & Frank in Portland [Ore.]. Gerry Frank is an important member of the community. He said, "Go ahead and change the name elsewhere, but don't change it here. It's part of the fabric." When it came time to make the decision, I flew out and said I had great respect for him and the brand, but renaming the stores would benefit the market.

The same was true with Marshall Field's in Chicago, which came through our acquisition of May Department Stores. On the day we announced we were renaming it Macy's, I flew to Chicago and I met with Mayor Daley. I wanted to tell him first. Now our business in Chicago is among the best in the nation.

The reality is that the change didn't impact sales in a negative way. It was critical that we operate under one national brand. More than 40 percent of the inventory we now sell is unique to Macy's. That would not have been possible before. This year is shaping up to be one of the best in many for the company. If we hadn't made that decision a few years ago, the external environment would have forced it on us. It was the right choice. Ⓑ —*As told to Diane Brady*

JIN LEE/BLOOMBERG

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